

**ISOLATING PROLIFERATORS AND SPONSORS OF  
TERROR: THE USE OF SANCTIONS AND THE INTERNATIONAL  
FINANCIAL SYSTEM TO CHANGE REGIME BEHAVIOR**

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**JOINT HEARING**

BEFORE THE

SUBCOMMITTEE ON TERRORISM,  
NONPROLIFERATION, AND TRADE

OF THE

COMMITTEE ON FOREIGN AFFAIRS

AND THE

SUBCOMMITTEE ON  
DOMESTIC AND INTERNATIONAL  
MONETARY POLICY, TRADE, AND TECHNOLOGY

OF THE

COMMITTEE ON FINANCIAL SERVICES

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**ISOLATING PROLIFERATORS AND SPONSORS OF TERROR:  
THE USE OF SANCTIONS AND THE INTERNATIONAL FINAN-  
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**WEDNESDAY, APRIL 18, 2007**

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON TERRORISM,  
NONPROLIFERATION, AND TRADE,  
COMMITTEE ON FOREIGN AFFAIRS AND  
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL  
MONETARY POLICY, TRADE, AND TECHNOLOGY,  
COMMITTEE ON FINANCIAL SERVICES,  
*Washington, DC.*

The subcommittees met, pursuant to notice, at 2:28 p.m. in room 2172, Rayburn House Office Building, Hon. Brad Sherman (chairman of the Subcommittee on Terrorism, Nonproliferation, and Trade) presiding.

Mr. SHERMAN. Thank you all for coming. Let me thank the chairman and ranking members of the two subcommittees and the chair of the two full committees, Chairman Frank and Chairman Lantos, for working together in order for these hearings to take place. We have an ambitious agenda this afternoon so we will try to limit opening statements, and I will see if I am able to limit my own. I will ask the witnesses to limit their statements to 5 minutes, but your full statement can be made part of the record of this hearing.

The greatest challenge to America is combatting terrorism and proliferation of WMD. The greatest power of America is our economic power. It is long past time that we have hearings to see how we can bring our greatest power to deal with our greatest threats to our national security. We recently saw success in the use of this economic power where actions that seemed rather small with regard to one particular bank in Macau and a \$25 million account played an important role in bringing North Korea back to the three-party talks.

In looking at the objectives we are trying to achieve, we must turn to those proliferating and terrorist countries and limit or eliminate loans to their government, investments in their royal sector, all other investments and their non-energy exports. I will focus my comments on Iran, but just about everything I have to say is equally applicable to Sudan and to other countries who ought to be targets of our efforts.

Our goal is to affect the behavior of U.S. companies and their subsidiaries, foreign companies, particularly oil companies and banks, the World Bank and other international organizations. Before the House Foreign Affairs Committee we have the Iran

Counter Proliferation Act authored by Chairman Lantos and co-sponsored by myself and others who are here today which is designed to really apply what was originally the Iran-Libya Sanctions Act. That Act was actually applied against Libya, and never really applied against Iran.

Both the Clinton and current Bush administrations simply violated their responsibilities under law, and we ought to see whether our witnesses can explain why the Iran-Libya Sanctions Act has yet to be applied. The bill would also prohibit United States companies from doing business with Iran through their foreign subsidiaries, and finally it would eliminate non-energy imports from Iran because I believe that preventing the development of nuclear weapons is more important than whether all types of caviar can be imported into the United States. I am willing to tell my constituents that they can make do with the Russian caviar.

In the area of banking and investments, there are a number of steps we can take. The Treasury Department has prevented two Iranian banks from doing business through the Federal Reserve Bank in New York, and thus prevented those two Iranian banks from doing major dollar transactions. We would like to find out why we are not doing that to all Iranian banks, and for that matter, all the banks of Sudan.

This subcommittee, rather my distinguished co-chairman Mr. Gutierrez's subcommittee, has jurisdiction over the World Bank. Now, I know we are all concerned about how one particular woman at the World Bank got \$193,500. Very concerned about the \$193,500. We need to be just as concerned about whether \$1.35 billion is going to be disbursed from the World Bank to the Government of Tehran as so far the United States has acquiesced in the process designed to lead to that result.

A particular focus of these hearings is the efforts to develop legislation designed to empower American investors to separate themselves from terror. Here the decision makers are pension plan managers, pension plan participants, and private investors. We need to allow pension plan managers to divest from those companies that do business with terrorist states without worrying about either of two legal issues, both of which we can deal with in the House Financial Services Committee.

One of those legal issues is the argument that the investors have a fiduciary duty to continue to invest in companies that invest in terror. That is wrong, and we can say so by law. Second is the idea that if State municipalities divest, that they are somehow carrying on a foreign policy in contradiction to U.S. foreign policy. We should both authorize and encourage our States and localities to divest from those who invest in terror.

We need to name and shame so that there is an official Treasury Department list of those who are doing business with sponsors of terror, proliferation and genocide. We need to allow individual employees who want to divest, and who have control over their own investments, to do so. If a company allows you to invest in a Fortune 500 or an S&P 500 fund, there ought to be an S&P 495 fund. That is to say, an equivalent investment that excludes terror.

In the jurisdiction of the House Ways and Means Committee, we ought to be able to turn to individual investors and say that they

can sell the stocks of those companies that are doing business with terror, reinvest those funds in other stocks or similar mutual funds, and get a carryover basis because we should not tax divestment, we should encourage it. And finally, the House Financial Services Committee needs to look at banning companies that invest in terror from getting any capital on Wall Street.

With that, I would like to yield to my distinguished ranking member of the Subcommittee on Terrorism, Nonproliferation, and Trade, Mr. Royce from California.

[The prepared statement of Mr. Sherman follows:]

PREPARED STATEMENT OF THE HONORABLE BRAD SHERMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRMAN, COMMITTEE ON FOREIGN AFFAIRS' SUBCOMMITTEE ON TERRORISM, NONPROLIFERATION, AND TRADE

This joint subcommittee hearing has been called to look at what I believe to be the most important goal of our foreign policy: our efforts to produce the type of economic pressure on regimes that will force them out of the business of promoting terrorism and the development and proliferation of nuclear weapons.

Three countries come to mind as the greatest challenges to our foreign policy: Iran, North Korea and Sudan, all listed as State Sponsors of Terrorism by our State Department; two of these states have nuclear weapons programs and the third, Sudan, is complicit in the greatest humanitarian catastrophe of this young century, the genocide in Darfur.

North Korea, already one of the poorest and most isolated countries in the world, was brought back to the six-sided table at least in part due to the pressure exerted by the Treasury's actions against Banco Delta Asia, a small bank in Macao that had been accused of money laundering activity, including moving counterfeit U.S. dollars for the regime. The action against Banco Delta Asia had a ripple effect; never a popular business partner, North Korea found itself cut off from most of the banks that had previously done business with Pyongyang.

Of course, it will take a lot more than action against one or two banks to bring Iran to the table. I laud Treasury for the work it is doing to dissuade European banks from doing business with Iran, and for cutting two Iranian banks off from the U.S. financial system entirely. These are small steps, but good initial steps. Clearly, the Iranian economy has not been so severely dislocated as to cause a change of policy in Tehran.

Our failure to use all of the sanctions tools at our disposal, especially those contained in the Iran Sanctions Act (ISA), has led to a continued flow of investment into Iran's energy sector. I am entering into the record as part of my statement a document prepared by the Congressional Research Service detailing more than \$100 billion in energy investments since 1999 that are either underway or planned for the Iranian energy sector.

#### Post-1999 Foreign Investment in Iran Energy Sector

Date	Field	Company(ies)	Value	Output Goal
Feb. 1999	Doroud (oil)	Totalfina Elf (France)/ ENI (Italy)	\$1 billion	205,000 bpd
Apr. 1999	Balal (oil)	Totalfina Elf/ Bow Valley (Canada)/ENI	\$300 million	40,000 bpd
Nov. 1999	Soroush and Nowruz (oil)	Royal Dutch Shell	\$800 million	190,000 bpd
Apr. 2000	Anaran (oil)	Norsk Hydro (Norway)		?
July 2000	Phase 4 and 5, South Pars (gas)	ENI	\$1.9 billion	2 billion cu.ft./day

## Post-1999 Foreign Investment in Iran Energy Sector—Continued

Date	Field	Company(ies)	Value	Output Goal
Mar. 2001	Caspian Sea oil exploration	GVA Consultants (Sweden)	\$225 million	?
June 2001	Darkhovin (oil)	ENI	\$1 billion	160,000 bpd
May 2002	Masjid-e-Soleyman (oil)	Sheer Energy (Canada)	\$80 million	25,000 bpd
Sep. 2002	Phase 9 and 10, South Pars (gas)	LG (South Korea)	\$1.6 billion	?
Oct. 2002	Phase 6, 7, 8, South Pars (gas)	Statoil (Norway)	\$2.65 billion	3 billion cu.ft./day
Feb. 2004	Azadegan (oil)	Inpex (Japan) 10% stake	\$200 million Japan stake	260,000 bpd
Oct. 2004	Yadavaran (oil); deal includes gas purchases for 30 years	Sinopec (China) and ONGC (India)	\$70 billion (value of exploration not known)	300,000 bpd
June 2006	Gamsar block (oil)	Sinopec (China)	\$50 million	?
Jan. 2007	Golshan and Ferdows (offshore gas, includes downstream development and transportation)	SKS Ventures (Malaysia)	\$20 billion	100 million cu.ft./day
<b>Totals</b>			<b>\$100 billion+</b>	<b>Oil: 1.2 million bpd Gas: 5.1 billion cu.ft./day+</b>

## Pending Deals

Field	Company(ies)	Value	Output Goal
North Pars Gas Field (offshore gas)	China National Offshore Oil Co.	\$16 billion (includes purchases of the gas)	3.6 billion cu.ft./day
(1)Phase 13 and 14—South Pars (gas); includes building a liquified natural gas (LNG) terminal	Royal Dutch Shell and Repsol (Spain)	\$10 billion	?

Source: CRS Report for Congress, *The Iran Sanctions Act*. By Kenneth Katzman. Updated March 23, 2007

I know that the State Department may claim that many of these deals are not going to go through, or the full extent of the investments will not be realized; but it strains credulity to say that no single \$20 million investment has occurred in Iran in the past decade during any calendar year. The fact of the matter is that the State Department refuses to find evidence of the investments that would trigger the Act because they do not *want* to find evidence of such investments.

The argument against applying the Iran Sanctions Act is that by punishing Western and Asian oil companies we would punish the wrong people: our allies. But doing business with Iran at a time when we are trying to end that regime's pursuit of nuclear weapons is not a friendly act. Quite simply, we are running out of time to apply the kind of pressure on Iran it will take to end their nuclear weapons program. I hope that our State Department will show the resolve necessary to bring

our European and Asian friends along on a program of tough economic sanctions—measures strong enough to cause the Iranian regime to rethink its drive for nuclear weapons.

Beyond the secondary sanctions in the ISA, the United States has not even taken the basic step of cutting Iranian goods off from the U.S. market. In 2000, during a brief and largely imagined thaw in US-Iranian relations, the Clinton Administration decided to lift the total embargo on Iranian goods in the US. About \$170 million in goods are shipped from Iran to the United States every year. We do not import oil; instead we import things we do not need and that Iran cannot sell elsewhere: caviar and carpets. While not a massive sum, I would hope that in an effort to isolate the number one state sponsor of terrorism, we could learn to live without the caviar and carpets that the Iranians send us. What message does it send when we ourselves cannot even do that much?

Then there is the World Bank. Also starting in 2000–2005, the United States barely lifted a finger as \$1.35 billion in loans were approved by the Bank for nine separate projects in Iran. It is true that the U.S. Director at the Bank was required to vote no on these loans, but other than that, the Clinton and Bush Administrations both did little to prevent these loans. How isolated is a regime that receives loans from the World Bank, with the major Western economies happily supporting these loans over lame U.S. opposition? We should not be focused on whether Mr. Wolfowitz's friend received roughly \$200,000 from the World Bank, but instead whether that body disburses \$1.3 billion to Iran.

Finally, I want to mention another policy initiative, one that will add another layer of pressure on companies to stop doing business in Iran, Sudan, and other state sponsors of terror. A number of states, including California, are considering legislation that would require divestment of state funds from companies that do business in these countries. We are honored to have, as part of our second panel, a leader in this movement, Missouri State Treasurer Sarah Steelman.

Her state has already gone “terror-free.” As she will point out, this has not caused her state to see diminished investment returns. Missouri's terror-free investment strategy is now actually outperforming the previous state investment strategy. This is not merely a feel-good strategy of investment. I support divestment and terror-free investment in both the public and private sector because I believe that it will serve to isolate these regimes from foreign capital, will curtail their exports, and will help deprive these regimes of the goods their economies require. Divestment should be part of our strategy to isolate these regimes until they give up their drive for nuclear weapons and/or their support for terror.

I am working with Congressman Barney Frank and others on legislation that will provide a boost to the divestment and terror-free movement with respect to Iran. I will also begin the process this week of seeking cosponsors on a bill I am drafting that will address the tax consequences of divestment—when an individual or entity divests from a security or other investment because it is tainted by business connections to a state sponsor of terrorism, they should not face immediate tax liability. Instead, they should carry their basis over into their new, terror-free investments and pay the tax only when they sell those investments.

We need to use every economic and political lever at our disposal against countries that seek to develop nuclear weapons and support terrorism. Right now, we are not doing nearly enough.

Mr. ROYCE. Well I thank you, Mr. Chairman, for yielding, and I thank you for holding this hearing. The concept of the hearing, changing regime behavior, changing it through use of the international financial system, and I think by way of example we can look at what has worked and what has worked relatively recently.

The United States for years wrestled with North Korea's nuclear program, unable really to find an effective way to deter the creation of that program. Many, many approaches were tried but there is not anything that has been as dramatic as the Bush administration's decision to squeeze Banco Delta Asia. As we remember in December 2005, the Treasury Department imposed Patriot Act Section 311 sanctions against this small Macau based bank.

As Treasury stated, this financial institution was a primary money laundering concern because senior officials in the bank are working with North Korean officials to accept large deposits of cash

including counterfeit United States currency and agreeing to place that currency into circulation. A top Treasury official even called it a willing pawn for the North Korean Government.

I visited the government in Macau some years ago to raise concerns about this activity and to protest this money laundering of counterfeit dollars but I want to make the observation that the action by the administration targeting that bank did a great deal to get the attention of Pyongyang. It set off a chain of events that showed the power of the market and caused the North Koreans to come back to the nuclear negotiating table.

First there was a run on the bank, and that forced the Macau Government to seize control and freeze approximately \$25 million North Korean assets. Perhaps a greater consequence was the message that was sent to bankers throughout the region about the pitfalls of dealing with the North Koreans, and as a consequence of that several cut ties to the regime.

Pyongyang came back to the table, and when they did they wanted to talk about one thing. They said they wanted to talk about the money. The United States' willingness to discuss Banco Delta Asia led to the February 13 agreement. There is a lesson in this for us today at this hearing.

In recent testimony before the Foreign Affairs Committee, Assistant Secretary Hill testified regarding the Six-Party Talks that we have not and will not trade progress on denuclearization by turning a blind eye to some of these illicit activities. It appears, however, that we have done just that, and that I think is the other lesson not to let up, not to let up when you are using sanctions, and in the past few weeks, the United States has gone from willing to return legitimate portions of the \$25 million to offering to return the funds to North Korea for the betterment of the North Korean people, to returning the ill-gotten proceeds *cart blanche*.

Kim Jong Il knows that he is getting his \$25 million back but as of this moment I am still not sure what the United States is getting, and that is why once you start down this road with sanctions you have got to follow through. You have to be tough. The dear leader has also gotten the signal from the United States that there will be no price to pay for his counterfeiting. I am concerned, and as long as he puts forth promises on his nuclear program, the United States will bend its laws when it comes to other regimes counterfeiting our currency.

Concessions to North Korea on the financial front come as we are having some similar success against the regime in Iran and are finally considering turning up the financial heat on Sudan which is engineering a genocide. I am disappointed that the President did not go farther this morning during his Sudan speech and give Treasury the green light to cut off Sudan's dollar transactions with the U.S. financial system.

We have waited long enough. I have been to Darfur. I have been to camps that have been attacked, talked to survivors. Genocide is indeed occurring there. It is time for the United States to take this kind of decisive action. The Treasury Department's campaign to explain to leading financial institutions in Europe and around the world the risk of doing business with Iran has induced many, many

companies to significantly scale back or terminate their Iran-related business.

As a consequence, Iran is having a harder time moving hard currency around the globe. This is harming its economy. Hopefully it is harming and undermining the support for its nuclear program. Certainly high unemployment is part of the consequence. High interest rates in the country. Inflation in the country is part of the consequence of private banks moving out of Iran.

The private banking sector, however, has been a lot quicker than parent governments to comprehend the threat posed by Iran, and that is perhaps best exemplified by the European stance on their export credits to Iran. We have the private companies pulling out. We have the private banks pulling out but we have the government with their European subsidies to investments that otherwise would not be made. We have those continuing.

The latest U.N. resolution urges countries not to enter into new commitments for grants and financial assistance to Iran but given the British experience who found no takers when they asked their fellow Europeans to scale back on export credits during the hostage crisis. This will be an uphill climb with these governments.

Given this outlook, many in Congress prefer the approach of pressing sanctions against Europeans, energy companies that continue to invest in Iran's oil and gas sectors. The financial measures the United States has employed to face the challenges posed by Iran and North Korea have been potent yet we would be naive to think that there is a single silver bullet or cookie cutter sanctions approach when it comes to facing such complex challenges. As in Iran, North Korea and elsewhere, we have to take these approaches in tandem and apply them together with seriousness.

Mr. SHERMAN. Thank you, Mr. Royce. Now the distinguished senior chairman here, Mr. Gutierrez from Illinois, who I want to thank for putting together these joint hearings because I think these joint hearings are an excellent way for two committees to work on a very important problem. Mr. Gutierrez.

Mr. GUTIERREZ. Well thank you, Mr. Chairman, and I want to especially thank you, Congressman, for approaching me with the idea of this joint hearing. The camaraderie we are demonstrating today is a good indicator that our two subcommittees and our full committee counterparts are working together to address the issues of proliferation, and that addressing this issue is a priority for the 110th Congress.

I hope that our spirit of cooperation is mirrored by the executive departments and agencies we oversee, particularly the ones we have testifying before us today because interagency cooperation is vital to the success not just of any sanctions we impose but of stopping proliferators and state support of terrorism all together. I will keep my remarks brief as I want to hear from our witnesses, and there is a possibility we may be interrupted for votes.

But there is no way to overstate the importance of this issue in terms of our foreign policy. From genocide in Darfur to nuclear weapons programs in Iran and North Korea, I believe that some form of economic sanctions or divestments have to play a pivotal role in our response. I support U.N. sanctions but I question the effectiveness of those sanctions, and I believe the U.S. needs to

take a serious look at enhancing our unilateral measures. My subcommittee has already held a legislative hearing on Congresswoman's Barbara Lee's Darfur Divestment bill, and I hope the Financial Services Committee can move a version of that bill in the coming weeks.

Today I would like to hear from both our panels on the effectiveness of economic sanctions in general, specifically whether our current sanctions are working against Iran, and what changes should be made going forward. I want to thank all of the distinguished witnesses from both of our panels for appearing today to provide us with their insight, and I yield back the remainder of my time.

[The prepared statement of Mr. Gutierrez follows:]

PREPARED STATEMENT OF THE HONORABLE LUIS V. GUTIERREZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS, AND CHAIRMAN, COMMITTEE ON FINANCIAL SERVICE'S SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY POLICY, TRADE, AND TECHNOLOGY

Thank you, Mr. Chairman. And I want to especially thank you for approaching me with the idea for this joint hearing. The comity we are demonstrating today is a good indicator that our two subcommittees, and our full committee counterparts, are working together to address the issue of proliferation, AND that addressing this issue is a priority of the 110th Congress.

I hope that our spirit of cooperation is mirrored by the executive departments and agencies we oversee, particularly the ones we have testifying before us today, because interagency cooperation is vital to the success, not just of any sanctions we impose, but of stopping proliferators and state support of terrorism altogether.

I will keep my remarks brief as I want to hear from our witnesses and there is a possibility that we will be interrupted for votes on the House Floor.

But there is no way to overstate the importance of this issue in terms of our foreign policy. From genocide in Darfur, to nuclear weapons programs in Iran and North Korea—I believe that some form of economic sanctions or divestment have to play a pivotal role in our response.

I support U.N. Sanctions, but I question the effectiveness of those sanctions and believe the U.S. needs to take a serious look at enhancing our unilateral measures.

My subcommittee has already held a legislative hearing on Congresswoman Barbara Lee's Darfur divestment bill and I hope the Financial Services Committee can move a version of that bill in the next few weeks.

Today, I would like to hear from both of our panels on the effectiveness of economic sanctions, in general, specifically, whether our current sanctions are working against Iran, and what changes should be made going forward.

I want to thank the distinguished witnesses from both our panels for appearing today to provide us with their insight and I yield back the remainder of my time.

Mr. SHERMAN. Thank you, Chairman Gutierrez, and now the ranking member of your subcommittee, Mr. Paul.

Mr. PAUL. Thank you, Mr. Chairman. I understand the concerns of my colleagues about the various nations that have been abusive with their rules and laws in their country. I share those concerns, and I share the goals sought by those who support sanctions but I do not share those same opinions. I have a different opinion regarding the success of sanctions, and my concern is very general and very philosophic. It is in no way a reflection of any sympathy for the authoritarian regimes such as we have running Iran right now, and I say that with sincerity because quite frankly I think sanctions too often make things worse rather than better.

I strongly oppose any move to initiate further sanctions on Iran. Sanctions are acts of war, and expanding sanctions on Iran serves no purpose other than preparing the American people for an eventual attack on Iran. This is the same pattern we saw in the run up to the war on Iraq. Congress passes legislation calling for re-

gime change, sanctions are imposed, and eventually we are told that only an attack will solve the problem. We should expect the same tragic results if we continue down this path. I urge my colleagues to reconsider.

I oppose economic sanctions for two very simple reasons. First, they do not work as effective foreign policy. Time after time from Cuba to China to Iraq, we have failed to unseat despotic leaders, to change their policies by refusing to trade with the people of those nations. If anything, the anti-American sentiment aroused by sanctions often strengthens the popularity of such leaders who use America as the convenient scapegoat to divert attention from their own tyranny.

History shows that free and open trade does far more to liberalize oppressive governments than trade wars. Economic freedom and political freedom are inextricably linked. When people get a taste of goods and information from abroad, they are less likely to tolerate a closed society at home. So sanctions mostly harm innocent citizens and do nothing to displace the governments we claim as our enemies.

Second, sanctions simply hurt American industries, particularly agriculture. Every market we close to our nation's farmers is a market exploited by foreign farmers. China, Russia, the Middle East, North Korea and Cuba all represent huge markets for our farm products yet many in Congress favor current or proposed trade restrictions that prevent our farmers from selling to the billions of people in these areas.

We must keep in mind that Iran has still not been found in violation of the Nonproliferation Treaty. Furthermore, much of the information regarding Iran's nuclear program is coming to us via thoroughly discredited sources like the MEK, a fanatical cult that is on our State Department's terror list.

Additionally, the same discredited neoconservatives who pushed us into the Iraq war are making similarly exaggerated claims against Iran. How often do these experts have to be proven wrong before we start to question their credibility? It is said that we non-interventionists are somehow isolationists because we do not want to interfere in the affairs of foreign nations but the real isolationists in my opinion are those who demand that we isolate certain people overseas because we disagree with the policies of their leaders.

The best way to avoid war, to promote American values, and to spread real freedom and liberty is to engage in trade and contacts with the rest of the world as broadly as possible and to set an example here at home so others will want to emulate us. I urge my colleagues to reconsider this counterproductive and dangerous move toward more sanctions on the various countries, and I yield back the balance of my time.

Mr. SHERMAN. Thank you. Now the chairman of the full Financial Services Committee, Mr. Frank.

Mr. FRANK. Thank you, Mr. Chairman. I am particularly pleased that we have taken the two committees, the unusual step of a joint hearing, and I hope that will be an indication of the seriousness with which we address this issue, and I think that sanctions have proven they work if they are appropriately applied. One of my

proudest moments as a public official was standing in Statutory Hall with hundreds of my colleagues and hearing Nelson Mandela thank the Congress of the United States for overriding the veto by President Reagan and passing a sanctions bill which Nelson Mandela told us was critical to the establishment of freedom for him to the end of apartheid.

Now, obviously unilateral sanctions are often counterproductive. Sanctions can be badly done but when there is a worldwide consensus, sanctions can be useful. I believe information we are now getting from Iran shows that it is not a monolith, and that in fact sanctions appropriately applied can have some impact on the decisions being made by the Government of Iran.

There are combined jurisdictions here. The Financial Services Committee jurisdiction deals with a couple of things which I would say to my good friend from Texas really reduce the influence of government in general and the Federal Government, and are in fact aimed at enabling other entities to make decisions on their own. Let me begin with the most, to take a phrase, libertarian of all, namely when people have approached investors who are fiduciaries who invest on behalf of others and say, do not enable Sudan to engage in genocide by investing in these companies. Do not enable Iran to engage in its saber rattling and its adventurism and potential nuclear weapons acquisition.

They are often told, well you know we sympathize but we have a fiduciary responsibility to make every last nickel, and if we can make every last nickel by investing in Sudan or Iran or in companies that do business, we are obligated to do so. The legislation we are contemplating in our committee would not mandate anybody to do anything but it would enable them to do it if they want to.

Essentially I regard this as the kind of anti-Geraldine legislation for those who remember Flip Wilson. We go to companies and say, you should not invest with these people, and they say, well the devil makes me do it, and our legislation will say, no, the devil does not make you do it anymore. The devil here being this claimed fiduciary responsibility.

So what we are talking about doing is freeing companies from the fear of being sued, and those who tell me that they think we have far too much intrusion from the legal system in the affairs of a company should be doubly supportive of this bill because from our committee's jurisdiction we are going to say that if a company decides for a variety of reasons, reputation, risk and other things that they will divest from a particular country which is doing these bad things and the way in which we will be listing these as part of the bill, then they may do so without fear of lawsuit. That is not an intrusion into the affairs of these companies. It is freeing them from a restriction.

Similarly, we have had States told, the State of Massachusetts tried to boycott the outrageous regime in Burma with State money, and was enjoined from doing so in a case that ultimately was decided by the Supreme Court but the Supreme Court appeared to say this could be done statutorily, and so what we think we should do is let the States decide what to do with their own money. We are not contemplating letting a State mandate private investment

decisions. We are contemplating empowering States with their own money, by their own democratic processes, to make these decisions.

So those are two aspects, although there are other aspects of the bill, but the two particularly relevant to our committee I believe empower these entities. If the gentleman would ask me to yield, I will.

Mr. PAUL. Yes. I would like to have you yield for just a minute. You know if what you say is true and is truly voluntary, I would not put that in the category of a sanction, and quite possibly I will be studying that very closely because I think voluntary sanctions are quite all right.

Mr. FRANK. Well I appreciate that, and I do not mean by this to conclude on any other part of the argument. There are different jurisdictions but within the jurisdiction of the Financial Services Committee, that is what we contemplate doing, and what we are saying is we think this will allow the American people who you know have clearly shown their revulsion at the outrageous mistreatment of people in Sudan genocide who have shown how appalled they were by the outrageous claims of the Iranian Government about the holocaust, about Israel's right to exist, about nuclear weapons, and about other things.

We will be empowering private entities and States to make their own decisions, and I thank my friend from Texas. We get together on this maybe we will get the rest of them to come with us on gambling.

Mr. SHERMAN. Thank you, Mr. Chairman. Is there any other member that wants to make a brief opening statement? I will ask you, Mr. Scott, to keep it brief, and you are vice chair of our committee so please proceed briefly.

Mr. SCOTT. Thank you. Certainly I will be brief because I would like to get right to the meat of it but I would like to certainly put on the table I think that any meaningful discussion today will certainly have to include a discussion on just what the Russians are up to. I mean what good are sanctions if you have got a country like Russia who is in the process of completing a \$750 billion arms deal to Iran? And what must we do to bring Russia into the sphere of corporation with sanctions?

China the same thing. How effective are sanctions if we go this route because I think it begs the point that my colleague, Mr. Paul, was mentioning. I mean can sanctions really work? Iran has continued to move forward. The other point I would certainly hope we put on the table is the issue of the sanctions on the processed gasoline that is coming back into Iran. I mean there seems to be some hesitancy there, and that is where we can really hit them if we are going to deal with sanctions.

You can hit them where they hurt. They have got all of this raw processing of the petroleum but they do not have the internal refinery capacity refining the gasoline. They have to import that in. So I think those are two points on the refining of the gasoline as a force of import, and then to really discuss the issues of what the Russians and the Chinese are really up to and can we bring them in. Thank you.

Mr. SHERMAN. Thank you. I hope we can now——

Mr. LYNCH. Mr. Chairman? Mr. Chairman?

Mr. SHERMAN. Yes?

Mr. LYNCH. May I?

Mr. SHERMAN. Briefly.

Mr. LYNCH. Very briefly. Thank you, Mr. Chairman, Chairman Sherman, Chairman Gutierrez. I have a special role in terms of I co-chair the special task force on antiterrorist financing along with Mr. Royce. I just came back a couple of days ago from Iraq, Afghanistan, Turkey and Jordan for the specific purpose of trying to tighten up some of the anti-money laundering and antiterrorist financing and legislation in those countries, and I want to say how happy I am that we have got a joint hearing going on this, and I think it is one of the most fertile areas for us to actually make an impact on the conduct of some of these countries.

And it is not simply an issue of us asking these countries to do the right thing for reasons of democracy but I think the sensitivity here is that many of these countries from an antiterrorist financing standpoint and an anti-money laundering standpoint want the investment from the international markets, and that is where the pressure points are, and I think they will respond to that.

I do want to say there are a couple of examples of our success. One, on December 14 President Hanya from the Palestinian Authority was caught bringing \$30 million in cash in a suitcase across the Rafah Gate into Egypt. From Egypt rather trying to get into the Gaza Strip. And that tells me that he cannot wire that in. That is his problem, and that is a good thing.

Secondly, we intercepted a letter from Ayman Al-Zawahiri some time ago asking for \$100,000 from his compatriots in al-Qaeda which tells me he is running short on money as well. So these are fertile areas where I think we can make an impact, and you know I want to join with the committee chairs and ranking members to make that happen, and with that I will yield back.

Mr. SHERMAN. Thank you. We will now hear from our first witness, Ms. Patricia McNerney, the Principal Deputy Assistant Secretary for the Bureau of International Security and Nonproliferation. Her Bureau leads the State Department effort to prevent the spread of nuclear, chemical and biological weapons and their delivery systems. Thank you.

**STATEMENT OF MS. PATRICIA McNERNEY, PRINCIPAL DEPUTY ASSISTANT SECRETARY, BUREAU OF INTERNATIONAL SECURITY AND NONPROLIFERATION, U.S. DEPARTMENT OF STATE**

Ms. McNERNEY. Thank you, Mr. Chairman, and Ranking Member Royce. I am pleased to have the opportunity today to address one of the most serious threats to international peace and security, how to keep the world's most dangerous people from acquiring and using the most destructive weapons. The Bush administration has pioneered some innovative approaches and developed more flexible programs and initiatives to combat the proliferation of weapons of mass destruction including by developing proliferation related financial and economic measures, the subject of today's hearing.

I would like to highlight the steps we are taking to impose financial costs on proliferators, the regimes that proliferate as well as those that facilitate and support them. Proliferators rely upon sup-

port networks to facilitate their trade which include supporters, financiers, logistical support, front companies, assets, shippers and facilitators. Similar to international criminal networks, proliferation networks operate for financial gain and depend on the international financial system to carry out their transactions and business deals.

We have a number of initiatives to prevent and disrupt shipments of concern but have also increased our work in the financial area as proliferation networks are highly vulnerable to disruption of financing and support. While the United States has the authority to take actions unilaterally with significant impact, an important element of our effort has been to broaden and deepen international cooperation to strengthen the impact of these actions.

Key to this effort has been our work in the Security Council to multilateralize these efforts. U.N. Security Council Resolution 1540, adopted in 2004, creates broad Chapter VII legally binding requirements on all states to criminalize the proliferation of weapons of mass destruction including the financing of proliferation.

U.N. Security Council Resolutions 1695 and 1718, adopted in 2006, prohibit states from supporting North Korean proliferation and provide a process for designating specific entities for an asset freeze. U.N. Security Council Resolution 1737 and 47, adopted in 2006 and 2007, among other requirements prohibits states from supporting Iran's enrichment in heavy water nuclear programs as well as the ballistic missile programs, and specifically designates 50 entities and individuals requiring nations to freeze their assets.

As part of our diplomatic work to ensure implementation of these resolutions, we are cooperating with nations to strengthen national legal authorities to carry out these mandates. For example, we are working through existing mechanisms like the financial action task force—which my Treasury colleagues will discuss in more detail—to augment legal authorities as well as through the Proliferation Security Initiative to strengthen information sharing between the 80 partner nations.

Developing nontraditional tools to disrupt proliferators led to the issuance of Executive Order 13382. President Bush signed this order in June 2005, authorizing the U.S. Government to freeze assets and block transactions of entities and persons engaged in proliferation activities. It also denies persons designated under the order access to the U.S. financial markets, and prohibits U.S. persons wherever they are located from transacting or dealing with such entities.

To date the United States has designated 35 entities and two individuals under the Executive Order, including entities and individuals from Iran, North Korea and Syria. Most recently the Department of State used its authority under the Executive Order to designate Defense Industry's Organization of Iran, one of the entities identified in the annex of the Security Council Resolution 1737. The Executive Order designations in concert with strong diplomatic approaches have prompted responsible financial institutions around the world to take a closer look at their own operations and to deny financial services to entities involved in proliferation.

As a result of the loss of access to many financial institutions, proliferators and illicit actors have been forced to wage an aggres-

sive campaign to reconstitute their financial networks, combing the world in search of banks willing to handle their business. It is for this reason that gaining international support for our efforts in an essential element of our ability to ensure proliferation networks are denied financial services worldwide.

We have seen a gradual increase in the readiness of our partners around the world to work with us to ensure that proliferators do not find easy access to these global financial institutions. For example, Japan and Australia joined the United States in designating each of the North Korean entities designated under our Executive Order. The Royal Bank of Canada restricted entities and individuals from a number of countries of concern, including North Korea, Iran, Syria and others.

The European Union adopted a strong common position to implement the asset freeze required by the Security Council Resolution 1737 and 1747 as well as to designate some additional entities and individuals. The EU common position also takes positive steps beyond the mandate of the U.N. Resolutions by imposing a travel ban on named individuals, a complete embargo on arms transfers to and from Iran, and prohibiting new commitments for grants, financial assistance and loans.

As part of our diplomacy, we have worked with Treasury to engage foreign governments and private firms, reminding them of the financial and reputational risks of doing business with Iran. When possible we have shared information with governments of proliferation-related transactions to ensure financial institutions have a full understanding of the activities of their customers. This has yielded results.

Additionally, the Islamic Revolutionary—

Mr. SHERMAN. Excuse me. I have been tapping to indicate that you need to wrap up. You are now well over time.

Ms. MCNERNEY. Okay.

Mr. SHERMAN. Do you have a couple concluding sentences?

Ms. MCNERNEY. I just want to mention the Islamic Revolutionary Guard Corps, a key element of Iran's regime to support international terrorism and proliferation, is taking an increasing influential role. For this reason we worked with many of our partners in the Security Council to designate a number of the entities engaged in proliferation. Obviously our overall approach is to collaborate with our international partners and many of these efforts have been positive in that regard.

[The prepared statement of Ms. McNerney follows:]

PREPARED STATEMENT OF MS. PATRICIA MCNERNEY, PRINCIPAL DEPUTY ASSISTANT SECRETARY, BUREAU OF INTERNATIONAL SECURITY AND NONPROLIFERATION, U.S. DEPARTMENT OF STATE

COMBATING WMD PROLIFERATION SUPPORT NETWORKS: FINANCIAL AND ECONOMIC SANCTIONS

#### *Introduction*

I am pleased to have an opportunity to address one of the most serious threats to international peace and security—how to keep the world's most dangerous regimes from acquiring and using the most destructive weapons. I'd like to take this opportunity to discuss the Administration's strategy to address these critical challenges to our national security, and the steps we are taking to impose financial costs on proliferators, the regimes that proliferate and those who facilitate and support them.

*Evolving Threats Demand Innovative Responses*

Preventing the proliferation of weapons of mass destruction materials, technologies and expertise, to terrorist organizations and rogue regimes is one of our highest national priorities. One of the most dangerous threats we face in the twenty-first century comes from states of concern, such as Syria, North Korea and Iran, not only due to their own development of weapons of mass destruction, but also for their potential to sell, transfer, facilitate, finance, or otherwise deliver weapons of mass destruction to terrorists or terrorist organizations.

With advances in economic integration and significant growth in the volume and speed of international travel and trade, weapons proliferators—both state and non-state actors—now find it easier to transfer sensitive items globally, and it is becoming more challenging for governments to monitor and control these transactions.

Proliferators and states of concern know this and mask their acquisitions as innocent, seemingly legitimate business transactions. They are exploiting the boom in global commerce by operating in countries with high volumes of international trade, finding countries with lax export control laws and enforcement, or utilizing free-trade zones, where their illicit procurements and shipments are more likely to escape scrutiny.

The United States is committed to working with the international community to solve this problem. We must work together to strengthen global nonproliferation mechanisms and to close the loopholes that proliferators exploit. The United Nations Security Council acted under Chapter VII of the UN Charter to adopt resolution 1540, which requires states to take steps to combat proliferation. The Security Council has also taken unanimous action against the dangerous behavior of Iran and North Korea by imposing sanctions under Chapter VII of the UN Charter when passing resolutions 1695, 1718, 1737 and 1747. With these binding resolutions, we have a strong international legal mandate for targeted actions against proliferation activities. Through aggressive implementation of these measures, the international community will ensure that those who abide by these obligations obtain the benefits of access to the international financial and commercial system and those who do not experience the consequences of denied access. This in turn protects the international commercial and financial system from exploitation.

Since the terrorist attacks of 9/11, responsible members of the international community have been working to put in place financial tools to identify, disrupt and dismantle the financial networks that facilitate and support terrorism. The same tools that have been successful against terrorist networks can and should be used to disrupt and dismantle the financial networks that support the proliferation of weapons of mass destruction. These new financial tools give us a concrete way in which to target directly those individuals and entities we know are bad actors, to strike at the heart of their operations and take away their financial incentive to proliferate.

*A New Strategic Approach to Combating WMD*

The Bush Administration has pioneered innovative approaches and developed more flexible programs and initiatives to combat the proliferation of Weapons of Mass Destruction (WMD), including by developing new proliferation-related financial and economic measures. I would like to highlight some of the progress we have made in combating WMD proliferation as a result of these initiatives and programs. Sustaining these innovative efforts in 2007 is a priority of the Administration.

Proliferators rely upon support networks to facilitate their trade, which include supporters, financiers, logistical support, front companies, assets, shippers and facilitators. Similar to international criminal networks, proliferation support networks operate for financial gain and depend on the international financial system to carry out transactions and business deals. These networks are highly vulnerable to public exposure and the disruption of financing and support.

Effective counter-proliferation actions target the entire proliferation network. Our goals are to disrupt and impede the operations of WMD proliferators and their supporters; to isolate proliferators financially and commercially by denying them access to the international financial system; and to expose proliferators' activities publicly and warn unwitting facilitators globally.

The United States is working with international partners to implement UNSCRs 1540, 1695, 1718, 1737 and 1747; to strengthen our own national authorities and encourage other governments to establish new authorities similar to our proliferation finance Executive Order (E.O.) 13382; and to promote counter-WMD financing initiatives in the context of multilateral fora, including the Financial Action Task Force (FATF) and the Proliferation Security Initiative (PSI).

*New Initiatives to Target the Economic Underpinnings of WMD Proliferation*

In 2003, President Bush launched the Proliferation Security Initiative (PSI). Under this Initiative, we have partnered with over eighty nations to date to interdict WMD-related shipments and stop the facilitators of proliferation including those who finance it. PSI partners have cooperated dozens of times—both in concert with the U.S. and on their own—to prevent transfers of WMD-related materials.

The PSI's success in interdicting WMD-related materials led the President to call on greater law enforcement cooperation in the PSI. As part of this effort, the United States highlighted the importance of cooperating with PSI partners to impede WMD-related finances at the June 2006 High Level Political Meeting in Warsaw. PSI participants are uniquely positioned to play a leading role in sharing information to prevent financial networks from tapping into legitimate commercial and financial markets to support proliferation. PSI is one tool participating states can use to implement their requirements in UNSCRs 1540, 1695, 1718, 1737 and 1747 to prevent proliferation-related financial transfers. PSI participants have worked together to build their capacity to take action against WMD proliferation, and to strengthen their national proliferation-related authorities. Action against WMD financing is an important next step.

The United States also spearheaded the effort in the United Nations Security Council to pass UN Security Council resolution 1540—the first Chapter VII resolution to address proliferation generally. This resolution places binding obligations on all UN Member States to develop and implement authorities to combat proliferation, including controls that effectively deny proliferators and their supporters access to financing and other services of the financial system. The U.S. has taken a first step in the form of Executive Order 13382, which authorizes targeted financial sanctions against proliferation networks just as we have against terrorist networks.

Developing non-traditional tools to disrupt proliferators led to the development of Executive Order 13382, related to proliferation finance. Implementation of E.O. 13382 has been a priority of the Bush administration. President Bush signed the Order in June 2005, authorizing the U.S. Government to freeze assets and block transactions of entities and persons engaged in proliferation activities and their supporters. It also denies persons designated under the Order access to U.S. markets and financial systems and prohibits U.S. persons, wherever they are located, from transacting or dealing with such entities. These financial measures were originally used extensively to combat terrorist networks, but now have been applied with considerable success against the proliferation activities of North Korea, Syria, and Iran.

To date, the U.S. has designated 35 entities and two individuals under E.O. 13382, including from Iran, North Korea and Syria involved in the development of dangerous nuclear programs or the proliferation of weapons of mass destruction and their means of delivery. These entities should no longer be able to claim legitimacy, nor should they be allowed to reap the benefits of access to the international financial system. We urge financial authorities worldwide to develop and implement similar authorities that allow financial institutions to close or freeze any accounts held by such illicit actors at institutions in their jurisdictions, and take steps to ensure that the private sector ceases any dealings with these entities.

The E.O. 13382 designations in concert with strong diplomatic approaches by the Departments of Treasury and State have prompted many responsible financial institutions around the world to take a closer look at their own operations, and to cease providing enabling environments for entities involved in proliferation and other illicit financial activities. As a result of the loss of access to many financial institutions, proliferators and the illicit actors supporting them have been forced to wage an aggressive campaign to revise their financial networks, looking for banks willing to handle their business. It is for this reason that we must remain vigilant to ensure that entities engaged in proliferation and illicit activities are denied financial services worldwide.

We are utilizing E.O. 13382 to limit Iran's development and proliferation of WMD. Under the Executive Order, the United States has designated 15 Iranian and 4 Chinese individuals and entities associated with Iran's weapons of mass destruction and missile programs, and is preparing the appropriate legal documentation to designate additional entities as required by UNSCRs 1737 and 1747.

On January 9, 2007, the United States added Bank Sepah, Bank Sepah's chairman, and Bank Sepah International PLC, to Treasury's Office of Foreign Assets Control's (OFAC) list of Specially Designated Nationals and Blocked Persons under E.O. 13382 for their support of Iran's ballistic missile programs. The subsequent designation of Bank Sepah under UNSCR 1747 was the culmination of several months of diplomacy and joint efforts by the State and Treasury Departments to encourage countries to sever their relationships with Sepah and other Iranian banks. UNSCR 1747 obligates Member States to freeze the assets of branches of Bank

Sepah—thereby significantly restricting its ability to facilitate transactions for Iran’s WMD and missile programs. Many countries have acted quickly to freeze Sepah’s assets in their jurisdictions and prevent it from conducting any transactions to ensure they comply with their obligations in resolution 1747, as well as their obligation in resolution 1737 to prevent the provision to Iran of financial assistance related to transactions involving certain items of proliferation concern.

We are targeting additional entities under existing authorities, and more broadly encouraging foreign governments to scrutinize activities of Iranian financial institutions in their jurisdictions, and, whenever appropriate, limit or end their business dealings with them.

*International Efforts to Address the Financing of WMD Proliferation*

The United States is not alone in looking at how financial tools can play a key role in combating international security threats. The international community has begun to recognize that financial measures have an important role to play in combating proliferation of weapons of mass destruction and the maintenance of global security. By its unanimous adoption of UNSCRs 1718, 1737 and 1747 under Chapter VII of the UN Charter, the Security Council signaled that it will no longer tolerate the North Korean and Iranian regimes’ development of nuclear weapons and proliferation of WMD and their delivery systems.

These resolutions provide governments with an international legal mandate for taking specific, targeted actions against proliferators and others acting in support of North Korean and Iranian WMD-related programs. All Member States have an obligation to fully and effectively implement the provisions of the resolutions. We continue to work with our partners and urge governments to adopt the targeted financial sanctions as required under the resolutions and to target all entities and individuals that meet the criteria therein, including those that are owned or controlled by designated entities and individuals.

Japan and Australia have already joined the U.S. in designating additional, DPRK-related entities and individuals for financial sanctions. More recently, the Royal Bank of Canada restricted entities and individuals from a number of countries of concern including North Korea, Iran, Syria, and others. Many responsible financial institutions have decided on their own, as a result of our continued diplomacy and exposure of North Korean proliferation entities’ illegal behavior, to cease business dealings with these entities.

The tide is turning against Iranian proliferation-related entities as well. To implement the requirements of UNSCRs 1737 and 1747, the European Union has amended the strong “Common Position” it originally adopted on February 27. The Common Position includes measures to implement the asset freeze required by the resolutions on entities and individuals listed in the annexes to the resolutions, but goes beyond the UNSCRs not only by imposing a travel ban on the individuals and a complete embargo on arms transfers to and from Iran, but also by prohibiting new commitments for grants, financial assistance, and loans. The Japanese government on February 17 adopted measures that imposed an asset freeze on all the entities and individuals listed in the Annex to UNSCR 1737, as well as measures to prevent the transfer of funds to, and goods from, Iran that are potentially proliferation-related.

The Islamic Revolutionary Guard Corps (IRGC)—a key element of the Iranian regime’s support for international terrorism, proliferation, and internal oppression—is taking on an increasingly influential role in Iran’s economy, with IRGC-affiliated companies winning important government contracts such as one for managing airports in Tehran. For this reason, we worked closely with our P-5 and UN Security Council partners to include a number of IRGC entities and individuals engaged in proliferation-related activity in UNSCR 1747.

Beyond imposing an asset freeze on various Iranian entities and individuals associated with Tehran’s nuclear and ballistic missile programs, UNSC resolutions 1737 and 1747 provide leverage to increase bilateral economic pressure. To this end, the Departments of State and the Treasury have engaged foreign governments and private firms, informing them of the financial and reputational risks of doing business with Iran. When possible, we have shared information with governments of proliferation-related transactions to ensure financial institutions have a full understanding of the activities of their customers.

These targeted financial pressures have denied suspect Iranian individuals and entities access to the US financial and commercial systems and with cooperation from other countries taking similar actions, will further isolate them from the international community, while making clear to Iran that activities in defiance of international law will result in real economic consequences. The Treasury and State Departments will continue to engage our foreign partners regarding such economic

pressures, as they are one of our most effective tools for making clear to the Iranian regime the cost of its continued defiance.

The U.S. will continue to support international initiatives as we refine our multilateral tools to combat the threat of proliferation, particularly by looking at how the international financial system can be leveraged to isolate such activities. We will also continue to work with our partners around the world on ways we can collectively strengthen our efforts to take action against WMD proliferators. We must expand our collaborative efforts in international organizations such as the Financial Action Task Force, the United Nations, PSI and other fora to meet this new responsibility to both strengthen our existing tools and creatively apply new tools.

*The WMD Challenges in 2007 and Beyond*

The threats of WMD terrorism and rogue state proliferation remain our pre-eminent WMD-related challenges. In 2007, my bureau will devote the majority of its diplomatic resources to addressing these issues using a range of tools, including the financial measures I have discussed today. To meet these challenges, we will continue to work closely with our friends and allies to strengthen the robust coalition of nations with whom we are working to block Iran and North Korea's nuclear weapons aspirations. A central challenge lies in convincing our partners to adopt innovative approaches to deter and roll back these programs, including through the use of financial enforcement measures against proliferators. We will also work to achieve full implementation of U.N. Security Council resolutions 1695, 1718, 1737 and 1747, and expect our partners to implement the obligations that these resolutions entail.

In order for our international legal mandates to be effective, governments must develop national legal authorities to implement them, and invest resources to apply these targeted economic and financial measures against a broad range of international threats, not just North Korea and Iran. One element of our work to develop an international legal framework has been in the Financial Action Task Force (FATF). We have worked with the G-7 to develop an Initiative to address the threat of weapons of mass destruction proliferation finance.

As my Treasury colleague will elaborate in a moment, the aim of the FATF initiative is to determine whether existing anti-money laundering and counter terrorist-financing standards should be reinforced to address vulnerabilities associated with WMD proliferation finance.

In the year ahead, we will also work to strengthen the Proliferation Security Initiative and expand our capabilities to address proliferation through cooperation with our PSI partners. PSI is an important tool we can bring to bear against state proliferation as well as the WMD terrorist threat.

Another key challenge for 2007 will be to harness the capabilities and willingness of the private sector to minimize the risk of proliferation and WMD terrorism. Many WMD terrorist attack scenarios will touch some element of the private sector, whether those elements are ports, financial institutions, or logistics providers. Public-private partnerships can play a key role in sensitizing the private sector to these risks and in encouraging them to take steps to cooperate to support our international security goals. For example, the global insurance industry can play a key role as a partner in mitigating the risk of WMD terrorism since they insure the international supply chain—the shippers, logistics providers, and port and airport operators—through which terrorist materiel, personnel, and capabilities might flow. The financial sector should also play a role by adopting internal compliance procedures that reduce the risk that terrorists or proliferators are exploiting their institutions to move or store resources to facilitate their illicit activities.

Since 9/11, we have taken significant steps to strengthen information sharing with the private sector through regulatory regimes that encourage suspicious activity reporting. Trade associations and individual companies in the nuclear, chemical, and bio-related fields have also taken voluntary steps to guard against exploitation of their infrastructure to acquire WMD capabilities. Governments can and should build on the willingness of the private sector to contribute to our security, since these approaches can complement more traditional approach of influencing the behavior of non-state actors through regulation and enforcement-related activities.

*Conclusion*

I would like to close by saying that the international community is becoming increasingly sophisticated in how it applies financial and other economic defensive measures to combat international security threats. This new era requires that governments and private sectors work together in close collaboration along with international partners to proactively seek out threats to international security and ensure that such threats are effectively isolated.

The security situation we face today is more complicated and requires flexible and targeted responses to the threats we face while protecting the integrity of the international commercial and financial system that underpins our way of life. The rogue states and terrorist organizations that seek weapons of mass destruction are adapting to our best efforts to stop them, and so we must develop and implement innovative tools and approaches to deter, detect, and defeat this growing menace.

But innovation alone will not win this fight. As Secretary Rice has articulated in her vision of transformational diplomacy, we must strengthen our partnerships—new and old—and ensure that they are tailored to the conditions of today. Only then will we be capable of succeeding in our fight against weapons of mass destruction in the twenty-first century.

Mr. SHERMAN. Thank you for your testimony. Next, I welcome Paul Simons, Deputy Assistant Secretary of State in the Department's Bureau of International Energy, Sanctions, and Commodities. Mr. Simons is the principle State Department official responsible for overseeing U.S. efforts to minimize the impact of international crime and halt the entry of illegal drugs into this country. Knowing that he can confine his statement to 5 minutes, Mr. Simons.

**STATEMENT OF MR. PAUL E. SIMONS, DEPUTY ASSISTANT SECRETARY, BUREAU OF ECONOMIC, ENERGY, AND BUSINESS AFFAIRS, U.S. DEPARTMENT OF STATE**

Mr. SIMONS. Thank you, Mr. Chairman. Actually that was my previous assignment but I am happy to continue to be a reference for that. Thank you for the opportunity to discuss this afternoon the economic dimensions of our strategy to address unacceptable behavior by regimes such as Iran, Sudan and North Korea. I would ask that my full statement be entered into the record, and I would just like to make—

Mr. SHERMAN. All full statements will be entered into the record without objection.

Mr. SIMONS. Thank you, Mr. Chairman. The main point I would like to make—and I will not take up much time because I think Deputy Assistant Secretary McNerney has really summarized it very well—is that smart sanctions in combination with other diplomatic and financial levers really represent a quite useful tool to bring pressure to bear on regimes around the world to change course, and the U.S. and the international community more broadly have been moving away from broader countrywide sanctions in favor of smart sanctions.

We have done this rather effectively in the United Nations context, and it has largely been as a result of U.S. leadership in the U.N. that we have been able to move the rest of the international community to accept smart sanctions as an important element in the toolbox. Targeted or calibrated sanctions make it clear that we are not taking aim, for example, at innocent civilian populations but rather at those individuals or entities who are specifically responsible for the dangerous behavior of a particular regime.

In my written statement I have provided more details on exactly how we are approaching Iran, Sudan and North Korea with respect to the use of these targeted multilateral sanctions but I would just like to conclude on one point. Several of your members asked are there any examples of success stories on sanctions? And I would like to note that this morning the United States introduced in the United Nations Security Council a new resolution that would lift

for the first time in 5 years the diamond embargo on the country of Liberia.

The U.N. Security Council in 2003 imposed this diamond embargo, and largely as a result of putting those sanctions in place the Liberian Government came around, developed the capacity to manage its diamond industry in a responsible way, and prepared the ground for a lifting of those sanctions, and I think the Liberia diamond experience as well as our broader experience through the Kimberley Process, the multilateral process that governs trade and conflict diamonds, is a good success story for sanctions.

It was a multilateral process. The U.N. was involved. We have 99 percent of global trade in rough diamonds now brought under a single multilateral. It is basically a sanction regime because if you are not in the group you cannot trade diamonds. So again I think it is a good example of multilateralism and sanctions and targeted sanctions achieving their desired impact. Thank you, Mr. Chairman.

[The prepared statement of Mr. Simons follows:]

PREPARED STATEMENT OF MR. PAUL E. SIMONS, DEPUTY ASSISTANT SECRETARY, BUREAU OF ECONOMIC, ENERGY, AND BUSINESS AFFAIRS, U.S. DEPARTMENT OF STATE

“PUNISH THE PROLIFERATORS AND SPONSORS OF TERROR: USING FINANCIAL AND ECONOMIC SANCTIONS TO CHANGE REGIME BEHAVIOR”

INTRODUCTION

Thank you Chairman Sherman, Chairman Gutierrez, Ranking Member Royce, Ranking Member Paul, and members of the subcommittees for this opportunity to discuss the economic dimensions of our strategy to address unacceptable behavior by regimes such as Iran, Sudan, and North Korea. “Smart sanctions,” in combination with other diplomatic and financial levers, represent a useful tool to bring pressure to bear on these regimes to change course.

By “smart sanctions,” we mean carefully targeted sanctions that directly focus on specific bad behavior and bad actors—rather than broad country-wide embargoes. Of course, the U.S. government can also be “smart” about comprehensive sanctions by calibrating their application through judicious use of licensing to show that our focus is on the regime, not the people. However, the United States has been moving away from country-wide sanctions in favor of “smart” sanctions. Targeted or calibrated sanctions make it clear that we are not taking aim at innocent civilian populations, but rather at those who control, and therefore can stop, the dangerous behavior of a particular regime. It is also easier to gain multilateral support for targeted sanctions, a crucial element in successfully bringing international pressure to bear on regimes to change their behavior. This holds true whether one is talking about preventing proliferation, stopping support for terrorism, keeping the diamond trade from financing brutal rebel movements or seeking to halt the violence in Darfur.

Multilateral sanctions often require patient diplomacy, but are worth the effort, as we have seen with the ultimate success in convincing Libya to end its WMD program and support for international terrorism. Effectively coordinated multilateral efforts also can produce dramatic results in other kinds of sanctions programs. The 71 countries participating in the Kimberley Process have successfully reduced the world’s trade in “conflict diamonds” to less than one percent of the market. The cooperation of the diamond industry has been a critical element in this success.

IRAN

The Administration’s sanctions policy toward Iran makes it clear that we target bad behavior by the regime but support the Iranian people.

Unfortunately, the government of Iran has engaged in a lot of bad behavior: pursuing nuclear proliferation; supporting terrorism; and contributing to regional instability. Other actions such as President Ahmadinejad’s denial of the Holocaust, Iran’s support for militants in Iraq, and the recent detention of British sailors in Iraqi wa-

ters have further underscored how out of step Iranian government policies are with the interests and concerns of the international community.

A sustained multilateral diplomatic strategy offers the best path to blocking Iran's dangerous ambitions. Some of the sanctions are aimed directly at increasing the difficulty for the regime to acquire the tools it needs for its unacceptable activities. Others are designed somewhat more broadly, to make clear to the Iranian regime that it will pay a high price—in terms of lost economic opportunities and international stature—for its reckless policies.

We have seen this approach bear fruit at the UN with the unanimous adoption on March 24 of UNSCR 1747 which reaffirms and expands those measures of UNSCR 1737 (December 2006) in targeting Iran's nuclear and missile programs. Among other requirements, the March resolution obligates states to freeze the assets of additional and specific entities and individuals associated with those programs. The resolution also calls on states and international financial institutions not to enter into new loans or grants with the Iranian government. World leaders have closed ranks against the Iran regime's refusal to comply with its international obligations. For example, the French Foreign Minister noted after its passage that the resolution reaffirmed the "clear choice confronting the Iranian leaders"—cooperate with the international community or worsen still further their international isolation.

Other financial measures have effectively leveraged this kind of message. State and Treasury officials have engaged with foreign governments and private firms to convey the notion that Iran's reckless behavior makes doing business with the regime a bad risk. Reinforcing the financial and reputational risks of doing business with Iran has had an impact on the availability of export credits from countries like France, Germany, and Japan and has led to reductions in access to banking services by several financial heavyweights.

We worked closely with Congress last year on the reauthorization and amendment of the Iran and Libya Sanctions Act (ILSA), which became the Iran Sanctions Act (ISA). Like its predecessor, ISA underscores the depth of U.S. concerns about Iran and provides a basis for continually raising those concerns with others. U.S. officials have vigorously engaged with key companies and countries about their potential investments in Iran's oil and gas sector. In making clear our opposition to such deals, we have emphasized the potential implications under the ISA, as well as the negative impact of such deals on international efforts to pressure Iran to suspend its enrichment-related and reprocessing activities and to enter negotiations pursuant to the P-5+1 offer of last year. Despite its resources, Iran continues to encounter great difficulty in attracting new investment to its hydrocarbon sector. Iran's own policies and actions have contributed to this situation, but ILSA/ISA and USG actions, including Treasury's efforts to discourage bank dealings with Iran, have played a role in creating the negative environment for investment that exists today in Iran. At the same time we think the focus of our sanctions efforts should be on Iran—as is the case with many of the sanctions we are discussing today—not on our allies. It vital that we maintain the unprecedented coalition that has come together to address Iran's problematic nuclear activities.

In addition, the U.S. government maintains comprehensive economic sanctions on Iran. These sanctions prohibit Americans and American companies from engaging in virtually all trade and investment activities with Iran. These prohibitions remain in full force but are carefully calibrated through licensing to permit a range of activities that make clear our support for the Iranian people.

The State Department provides foreign policy guidance to Treasury's Office of Foreign Assets Control—OFAC—on licenses involving Iran. The U.S. government reviews licenses for agricultural and medical sales, authorized under the Trade Sanctions Reform and Export Enhancement Act of 2000. This is the biggest license category. In 2006, State recommended approval on 502 of these licenses, covering tens of millions of dollars of exports. We draw on the Department's technical experts to ensure there are no possible dual use concerns, but still seek to expedite these licenses that benefit the general population of Iran, not the regime. We are especially concerned with swift processing of medicines for diseases like HIV and leukemia. We have also favorably reviewed a variety of other license applications for activities that can benefit the Iran public. Recent examples include civil society development, business school exchanges, earthquake safety seminars, conservation of endangered plants and animals, and medical training. On rare occasions, most recently in November 2006, we have permitted carefully controlled exports that are essential for the safety of civilian aviation. In short, the licensing process is an important part of comprehensive sanctions, allowing us to make it clear that our sanctions are intended to target the regime and its policies, rather than the general population.

### *Sudan*

The United States maintains extensive sanctions on Sudan. Sudan has been on our State sponsors of Terrorism list since 1997. In addition, the United States designated three Sudanese companies under Iran and Syria Non Proliferation Act sanctions in December of 2006.

The three main USG policy goals for Sudan at the moment are: a) provide life-saving humanitarian assistance to the millions of people who have been displaced or affected by violence in Darfur; b) promote a political settlement to the conflict and deploy a UN-AU hybrid international peacekeeping force to protect civilians; and c) support implementation of the Comprehensive Peace Agreement.

President Bashir's resistance to fulfilling his previous commitments regarding the UN-AU peacekeeping force have led the U.S. to seek additional ways to pressure the regime to change its behavior. Targeted sanctions are a useful tool in this regard, and the USG is actively engaged in increasing the pressure on Sudan using this tool both unilaterally and multilaterally.

The USG can also use sanctions to reward good behavior. Following the 2006 Darfur Peace and Accountability Act, we eased certain sanctions in Southern Sudan whose government is playing a constructive role in Sudan's peace efforts. Southern Sudan is taking advantage of this easing to develop new export industries such as gum Arabic, a natural resin much sought after by beverage, pharmaceutical, and printing industries. The easing of sanctions is also making it easier for Southern Sudan to attract expertise and materials for desperately needed infrastructure projects.

In terms of the comprehensive sanctions that remain in place on Northern Sudan, the USG uses licensing as a way to show that we are not targeting the people of Sudan. Sudan licenses are most common for food, medicine, and humanitarian efforts. Indeed, the USG has issued 161 NGO registrations and hundreds of specific licenses to groups performing relief work in Sudan. Other recent specific licenses have included water well mapping, community development initiatives, and archaeological research on Sudan's rich historical patrimony.

Smart sanctions and multilateral efforts remain the best way to achieve our policy objectives for Sudan.

### *North Korea*

The International community is deeply troubled by North Korea's destabilizing nuclear and ballistic missile programs, as reflected by the adoption of UNSCRs 1695 and 1718, which remain in effect. ISN and Treasury can best address our efforts to curb the regime's nuclear and missile proliferation ambitions in greater depth, but would like to simply emphasize here that in North Korea we need to continue with the multilateral approach as this is the best way to build an effective coalition that can have an impact on regime behavior. The Six-Party talks yielded a promising agreement to shut down the Yongbyon nuclear reactor and readmit inspectors. If North Korea meets its commitments, the U.S. will continue to work toward normalizing relations with the DPRK. From a sanctions perspective, this may include removing the designation of the DPRK as a State sponsor of terrorism, in accordance with the applicable statutory provisions, and advancing the process of terminating application of the Trading with the Enemy Act with respect to the DPRK.

### *Syria*

Syria is a country of concern as well, given its track record with regard to missile proliferation, support for terrorism, and contributions to regional instability. This is why the USG maintains prohibition on the export to Syria of any items that appear on the United States Munitions List (e.g., arms and defense weapons or ammunition) or Commerce Control List (e.g., dual-use items such as chemicals, nuclear technology, propulsion equipment, lasers). We also maintain other prohibitions including the export to Syria of American products, other than food and medicine and certain other excepted categories of goods.

### *Cuba*

The Cuban embargo denies the Castro dictatorship hard currency that it would use to oppress the Cuban people and to prop up the regime. The Cuban Democracy Act of 1992 and the Cuban Liberty and Democratic Solidarity Act of 1996 (the "Libertad Act") increased the restrictions on trade with Cuba, but also included provisions for allowing exports of food, medicine and medical equipment in support of the Cuban people. The State Department provides foreign policy guidance on approximately 30-50 Commerce and Treasury Department license applications each month. Easing sanctions, as defined in the Libertad Act, against Cuba will require verifiable movement toward democracy and an open market economy, which in-

cludes the release of political prisoners, respect for human rights, and a real commitment to hold free and fair elections.

*How to Define Success*

Success in any sanctions program is when changed behavior lets us remove sanctions. Libya is of course the prime example of a regime choosing to give up its nuclear ambitions and support for terrorism because of pressure brought to bear by sanctions, diplomacy, and other measures. However, we can also see success in other kinds of sanctions programs. For example, the UN has lifted sanctions on Liberian timber, and may soon allow Liberian diamond exports, so that those sectors can now be positive forces for Liberia's economic development. Some individual designations of arms traffickers, perpetrators of violence, and corrupt officials associated with former dictator Charles Taylor remain in place, but the positive evolution of Liberia's post-war reconstruction permits a gradual removal of the broader UN and USG sanctions.

Sanctions are a useful tool in our diplomatic arsenal. Admittedly, like any tool, they have their limits. Used properly, sanctions help bring pressure to bear on regimes responsible for nuclear proliferation, terrorism, and other breaks from international norms of acceptable behavior. The most effective sanctions are applied multilaterally and take aim at the leaders responsible for bad actions, not the general population.

Mr. SHERMAN. Thank you for your brevity. I welcome Adam Szubin, Director of the Treasury Department's Office of Foreign Asset Control, who is responsible for administering and enforcing the United States Government's economic sanctions programs.

**STATEMENT OF MR. ADAM J. SZUBIN, DIRECTOR OF THE OFFICE OF FOREIGN ASSETS CONTROL, U.S. DEPARTMENT OF THE TREASURY**

Mr. SZUBIN. Thank you, Chairman Sherman. Chairmen, ranking members and distinguished members of the subcommittees, thank you for the opportunity to testify on the vitally important issues of isolating proliferators and state sponsors of terrorism. The subject of today's hearing, the use of sanctions and the international financial system to change regime behavior speaks to the core purpose of my office, the Office of Foreign Assets Control, and the broader Office of Terrorism and Financial Intelligence at the Department of Treasury.

Our central mission is to use sanctions in a forceful and sophisticated way to pressure and isolate those who threaten our national security and to alter their behavior. Impact for us is typically measured in degrees of isolation rather than in dollars frozen. If a state sponsor of terrorism begins to fear that its trade partners are withdrawing, cutting off ties, that is a success. If a proliferation firm is rejected when it applies to transfer money or to open a bank account, that is a success.

Our objective is not sanctions for their own sake of course but to alter the decision-making calculus of state sponsors of terrorism and proliferators. We therefore are always looking to act in a concerted manner internationally, either with a coalition of like-minded states or the United Nations, and we work closely with the State Department and with our fellow finance ministries and central banks abroad to achieve those ends.

A key, if possibly counterintuitive lesson that we have learned, is that less can be more. Targeted sanctions narrow sanctions against specific individuals or entities that have violated international codes—whether they be counterproliferation, counterter-

rorism, anti-money laundering norms—may have a bigger impact than traditional embargo-type sanctions.

This is so because broad sanctions are often viewed by the private sector as obstacles to be worked around. By contrast, when we designate specific targets on the basis of such egregious conduct as we are discussing today, private actors, private banks, export firms, will often hasten to echo our steps, even voluntarily. Even foreign firms.

It is the rare international bank that is willing to host the business of terrorist groups, and the vast majority is of course eager for more information that we can provide to protect their businesses against such infiltration and abuse. This is why we take such pains to build evidentiary packages needed to spread the word about the behavior of those that we target and why we work so closely with the intelligence community to make sure that we can declassify portions of our record to explain why we are doing what we are doing.

By moving in tandem with—rather than against—the natural inclinations of the private sector, our sanctions have resonated across the international financial sphere, delivering a widespread and tangible impact. Our credibility and our influence can be as decisive here as our legal authorities. With respect to North Korea and Iran, in the past year we have taken many significant steps both alone and in concert with others to impose targeted financial measures, and we have seen the results.

North Korea was already a relatively isolated state but its nuclear weapons test and its brazen illicit conduct has led to its virtual excommunication from the world financial sector. In the banking world, North Korea is now a pariah. This is a result both of our actions but also of Kim Jong Il's regime. It is his behavior that has caused them to be excommunicated.

Iran, with a developed and heavily integrated economy, presents a very different scenario. Time does not allow me to outline the array of escalating steps that we and our partners have taken over the past 2 years to spotlight Iran's reckless behavior but I would like to highlight just one example. We at Treasury designated Iran's Bank Sepah in January of this year for its role in facilitating the proliferation activities of the Iranian Government. Our action carried financial consequences but what is notable for what it said as for what it did.

This major bank, one of the largest in Iran, with branches and accounts across the world, was actively facilitating Iran's missile industry, financing and processing dozens of multimillion-dollar transactions for Iran's aerospace industries organization. As a result of our action, banks in the United States were legally required to cut off relations, even direct, with Bank Sepah but banks in Europe, Japan and other financial centers also responded, limiting or cutting off entirely their ties to this bank of their own accord.

And thanks in part to the dedicated work of our State Department, Bank Sepah was then designated at the United Nations in March with the result that all countries worldwide are required to freeze its assets. Now one of Iran's largest banks stands to lose access to the world financial market and to the world's currencies without which a bank simply cannot survive.

The lesson to Iran and to North Korea as well as to those that would handle their proliferation activities could not be more clear. Together with my colleagues at the table and throughout the government, we will continue to direct all of our capabilities and resources against those that threaten our nation. As we do so, I look forward to working closely with your committees. Thank you again for the opportunity to testify today.

Mr. SHERMAN. Let me point out without objection that all of the witness statements in full will be made a part of the record and all opening statements of a written nature from members will be made a part of the record. With that, let us go to our last witness, Daniel Glaser, Deputy Assistant Secretary at Treasury in the Office of Terrorist Financing and Financial Crimes. Mr. Glaser is the primary Treasury Department official responsible for the development and coordination of international anti-money laundering and counterterrorist financing policy.

**STATEMENT OF MR. DANIEL GLASER, DEPUTY ASSISTANT SECRETARY FOR TERRORIST FINANCING AND FINANCIAL CRIMES, U.S. DEPARTMENT OF THE TREASURY**

Mr. GLASER. Thank you, Chairman Sherman, Chairman Gutierrez, Ranking Members Paul and Royce and distinguished members of the subcommittee for this opportunity to discuss the use of sanctions and other targeted financial measures to isolate proliferators and sponsors of terrorism. This is an important topic that touches at the heart of our efforts to protect and safeguard the nation from threats that are truly unthinkable, the proliferation of weapons of mass destruction is chief among these threats.

Since September 11 and even before our focus at the Treasury Department has been to apply our authorities and financial expertise to stop the flow of money to terrorists and others who would seek to harm our citizens. In this effort, it is critical that we continue to use every tool at our disposal, including the financial pressure and leverage that sanctions and other financial measures offer. These measures are not a silver bullet but it is becoming increasingly clear that they are an indispensable component to any comprehensive strategy to counter national security threats.

Over the last 5 years, we have increased substantially our understanding of the vulnerabilities in the international financial system and how terrorists and other illicit financial networks exploit those vulnerabilities. At the same time, we have steadily enhanced our skill and sophistication in applying the financial tools that we have at our disposal to close those vulnerabilities, disrupt and dismantle illicit financial networks and apply pressure on the states that provide terrorist support and comfort.

We have learned by communicating with the international private sector that we could make the international financial system a hostile environment for terrorists, financiers, and other illicit actors. We have worked with our allies and through international organizations to build a multilateral regime that leaves terrorists, financiers, and supporters little room to operate in the international financial system.

Armed with this expertise gained in the fight against terrorism, we are now focusing similar efforts on WMD proliferators and their

support networks. Four initiatives are worth nothing right now. First, we have worked closely with our State Department colleagues to create a multilateral regime to apply targeted financial measures to proliferation. Thanks to these efforts, we now have multiple Chapter VII U.N. Security Council resolutions that apply targeted financial sanctions to individuals and entities involved in Iran and North Korean related proliferation activity.

Second, we have launched an effort within the financial action task force to establish a consistent and effective global approach to the implementation of those resolutions. Third, we have employed a range of Treasury authorities, including targeted financial sanctions under Executive Order 13382 to isolate and disrupt illicit financial networks. We have also employed Section 311 of the USA Patriot Act to identify and safeguard the U.S. from money laundering vulnerabilities in the international financial system.

One well-known example actually referenced by Mr. Royce is Treasury's designation of Banco Delta Asia as a primary money laundering concern. Through this action, we have protected the United States and international financial systems from a bank that systemically failed to apply appropriate standards and due diligence as well as facilitated a gamut of deceptive financial conduct on behalf of North Korean related entities.

Finally, Treasury has engaged in unprecedented high level outreach to the international private sector that is focused on sharing information about deceptive financial behavior. For example, Treasury officials have met with more than 40 banks worldwide to discuss the threat Iran poses to the international financial system and to their institutions. In fact, Under Secretary Levey is in Europe having these types of discussions even as we speak.

The result of these efforts has been remarkable. It is clear that our efforts have not had just direct impact on the targeted entities but have also unleashed market forces that are making the international financial system an increasingly difficult environment for those who would use it for illicit purposes. In the case of Iran, financial institutions and other companies worldwide have begun to reevaluate their business relationship with Tehran as evidence of Iran's deceptive practices mount.

Many leading financial institutions have either scaled back dramatically or even terminated their Iran-related business entirely. They have done so of their own accord, many concluding that they did not wish to be the bank for a regime that deliberately conceals the nature of its dangerous and illicit conduct.

Likewise North Korea's increasing isolation from the international financial system is driven by the individual decisions of hundreds, if not thousands, of international financial institutions that the anti-money laundering risks of doing business with North Korea and related entities outweighs the potential profits.

I would close by offering a thought on the potential for future use of sanctions and other financial measures. We are just discovering the full impact and the power of the authorities and financial levers we have at our disposal. Prior to September 11, targeted financial measures were not regarded as an important component of our strategic response to national security threats. Today they are central to our approach to virtually all national security threats.

This is the case because financial measures are working. There are few actions that we have taken that have been as effective in grabbing the attention of our targets and in imposing real consequences. Treasury remains committed to fine tuning our application of financial and protective measures so that they can be used effectively against any threat at any time with a high level of success. Thank you, Mr. Chairman.

[The prepared statement of Mr. Glaser and Mr. Szubin follows:]

PREPARED STATEMENT OF MR. DANIEL GLASER, DEPUTY ASSISTANT SECRETARY FOR TERRORIST FINANCING AND FINANCIAL CRIMES AND MR. ADAM J. SZUBIN, DIRECTOR OF THE OFFICE OF FOREIGN ASSETS CONTROL, U.S. DEPARTMENT OF THE TREASURY

Chairmen Sherman and Gutierrez, Ranking Members Mr. Paul and Mr. Royce, and distinguished members of the Subcommittees, thank you for this opportunity to discuss the use of sanctions and other financial tools as a means of combating proliferation and terrorism—two of the most deadly threats of our time.

The United States has marshaled its full range of powers to stop the proliferation of weapons of mass destruction and to isolate and undermine terrorist groups. As the past few years have demonstrated, sanctions and other financial measures administered by the Treasury Department can play a meaningful role in isolating and pressuring national security threats, when applied in an aggressive and targeted manner. Sanctions can have a powerful impact but they are not a silver bullet and cannot be pursued in isolation. These measures work best when applied in concert with the diplomatic, intelligence, law enforcement, export, and military measures that our colleagues across the government are pursuing in such a dedicated manner.

Our testimony today will focus on the use and impact of financial measures, particularly in countering the threats posed by Iran and North Korea. We thank both of the Committees present for your strong leadership in confronting these threats and safeguarding our national security.

#### I. THE OFFICE OF TERRORISM AND FINANCIAL INTELLIGENCE

Congress established the Office of Terrorism and Financial Intelligence (TFI) following the September 11, 2001 terrorist attacks, to marshal the Treasury Department's unique regulatory, enforcement, intelligence, and policy capabilities against threats to our financial system and national security. It is the only office of its kind in the world. Under the leadership of Under Secretary Stuart Levey, TFI incorporates five components. Appearing at this hearing are representatives of the Office of Terrorist Financing and Financial Crime (TFFC) and the Office of Foreign Assets Control (OFAC). We work closely with our TFI colleagues—the Office of Intelligence and Analysis (OIA), the Financial Crimes Enforcement Network (FinCEN), and the Executive Office of Asset Forfeiture (TOEAF)—to identify and disrupt the financial networks of our enemies as well as to safeguard the U.S. and international financial systems.

OFAC, with approximately 135 staff, is charged with administering and enforcing economic and trade sanctions in furtherance of U.S. foreign policy and national security goals. OFAC administers approximately 30 economic sanctions programs against international terrorists, proliferators of weapons of mass destructions (WMD), state sponsors of terrorism, narcotics traffickers, and other threats to our national security. Although these programs differ in terms of their scope and application, they all involve the exercise of the President's constitutional and statutory wartime and national emergency powers to impose controls on transactions and trade, and to regulate or freeze foreign assets that come within the jurisdiction of the United States.

TFFC, with a staff of approximately 30, is TFI's policy and outreach apparatus on terrorist financing, money laundering, financial crime, and sanctions issues. It develops and implements strategies, policies and initiatives to identify and address vulnerabilities in the U.S. and international financial system and to disrupt and dismantle terrorist and WMD proliferation financial networks, and it formulates and promotes policies domestically and internationally to combat terrorist financing and financial crime.

We in TFI collaborate on a regular basis with our counterparts across the Treasury Department, and with a broad range of federal agencies, including the Departments of State, Commerce, Homeland Security, Defense and Justice, including the Federal Bureau of Investigation and the Drug Enforcement Administration; the

bank regulatory agencies; and other law enforcement and intelligence agencies. We also work very closely with the private sector and our foreign counterparts abroad to identify and address threats to our collective security and the international financial system.

## II. GENERAL OVERVIEW OF SANCTIONS AND THEIR IMPACT

Applying effective economic measures requires careful strategic, economic, legal, and policy analysis to ensure that the measures are calibrated to meet their goals and minimize unintended consequences. The objectives for these measures are typically to isolate the target as a means of inducing it to abandon harmful or threatening policies. Sanctions should not be expected to empty a regime's coffers and bring it to its knees. But they can alter the decision-making calculus of a regime by illustrating the costs that it faces in pursuing a dangerous or confrontational policy.

Because our tools are aimed at isolating our targets, we are most effective when we proceed multilaterally, either with a coalition or with the consensus of the United Nations. We work closely with the State Department and with our fellow finance ministries and central banks abroad to build consensus on financial measures.

At times, though, it is necessary for us to adopt unilateral sanctions. As it turns out, even when we initially act alone we can have a dramatic impact. There are two main reasons for this. First, because the United States is the world's leading banking and financial center and the dollar is the world's dominant currency, funds transfers often pass through U.S. banks. If a U.S. bank tries to send U.S. dollars somewhere in the world, the chances are that the money will pass through a U.S. bank. The result will be a funds freeze and a call to OFAC's compliance office. In this regard, it is important to remember that U.S. persons and U.S. branches situated abroad are subject to U.S. law and must comply with OFAC's sanctions as if they were in the United States.

The second contributor to our sanctions' effectiveness is that non-U.S. international financial institutions frequently implement our targeted sanctions voluntarily, even when they are under no legal obligation from their host countries to do so. These institutions may implement our sanctions because they do not want to engage in business with terrorist organizations or WMD proliferators, even if it is legally permissible. They may cooperate because of the reputational and business risks involved. Whatever the reason, this cooperation can provide a decisive "force multiplier."

We have learned that the key to obtaining such voluntary cooperation is directing our sanctions in a "targeted" fashion—namely, against those individuals or entities that have violated international codes of behavior, whether they be counter-proliferation, counter-terrorism, or anti-money laundering norms. This is why we take such pains to build the evidentiary packages needed to effectuate targeted sanctions as well as to provide a public explanation of the basis for our actions for the benefit of governments and private institutions around the world.

We are frequently asked how we measure the impact of sanctions or financial measures. Metrics can be difficult to come by, and can vary by context. An important measure of impact is our success in disrupting or disabling key support nodes, such as key financial institutions, trade partners, or donors. Another metric may be the extent to which foreign financial institutions and centers take similar steps to isolate the target. Ultimately, the most revealing indicator will be how the target itself sees our measures. Although such information can be fragmentary and highly classified, we have seen high-ranking officials within terrorist or criminal organizations or regimes subject to our sanctions programs struggling to manage the effects of our measures and worrying about what may be coming next.

## III. NORTH KOREA AND IRAN

In the aftermath of the September 11, 2001 attacks, the prospect of WMD falling into the hands of terrorists or state sponsors of terrorism has become an inescapably real threat. The Treasury Department has drawn upon its full range of authorities and influence to combat these threats.

### *Counter Proliferation Actions*

President Bush issued Executive Order 13382 in 2005, adding powerful tools—a broad-based transactions prohibition and an asset freeze—to the array of options available to combat WMD trafficking. By prohibiting U.S. persons from engaging in transactions with entities and individuals targeted by the order, we can effectively deny proliferators and their supporters access to the U.S. financial and commercial

systems, cutting them off from the benefits of our economy. These prohibitions have a powerful effect, as the suppliers, financiers, transporters, and other facilitators of WMD networks tend to have commercial presences and accounts around the world that make them vulnerable to exactly this kind of financial action, particularly since so many of the transactions are denominated in dollars.

In issuing Executive Order 13382, the President identified and targeted eight entities in North Korea, Iran, and Syria, thereby prohibiting U.S. persons from engaging in transactions with them and requiring any assets of those entities within their control to be frozen. The North Korean entities listed in the Annex to the order include Korea Mining Development Trading Corporation (KOMID); Korea Ryonbong General Corporation; and Tanchon Commercial Bank. Iranian entities in the Annex include the Atomic Energy Organization of Iran (AEOI); Aerospace Industries Organization (AIO); Shahid Hemmat Industrial Group (SHIG); and Shahid Bakeri Industrial Group (SBIG). The President then authorized the Secretary of State and the Secretary of the Treasury to designate additional proliferators of WMD and their supporters under the authorities provided by the Order.

Treasury has to date designated fifteen Iran-related and ten North Korea-related individuals and entities supporting Iran and North Korea's WMD and missile programs. One of the recent Iran-related designations was the fifth-largest Iranian state-owned financial institution, Bank Sepah, in January of this year. Bank Sepah has provided extensive financial services to Iranian entities responsible for developing missiles capable of carrying weapons of mass destruction. It has been a key provider of financial services to SHIG and SBIG, two Iranian missile firms listed in the Annex to UN Security Council Resolution 1737 for their role in advancing Iran's ballistic missile programs. Bank Sepah also provides financial services to SHIG's and SBIG's parent entity, AIO, which has been designated as a proliferator by the United States for its role in overseeing all of Iran's missile industries.

Since at least 2000, Bank Sepah has also provided a variety of critical financial services to Iran's missile industry, arranging financing and processing dozens of multi-million dollar transactions for AIO and its subordinates. The bank has also facilitated business between AIO and North Korea's chief ballistic missile-related exporter, KOMID. The financial relationship between Iran and North Korea, as reflected in the business handled by Sepah, is indeed of great concern to the United States.

Our designation of Sepah under E.O. 13382, and the subsequent imposition of sanctions on Sepah by UN Security Council Resolution 1747, has had a significant impact. By cutting off Sepah from the U.S. and the international financial system, we have commercially isolated Bank Sepah and may have made it more difficult for Iran to finance some of its proliferation-related activities.

#### *Counter Terrorism Actions*

Treasury took action late last year to cut off a second Iranian bank from the U.S. financial system because of its ties to terrorist support—Bank Saderat Iran, one of the largest Iranian state-owned financial institutions. Saderat is used by the Government of Iran to transfer money to terrorist organizations, most notably Hizballah. Since 2001, for example, a Hizballah-controlled organization received \$50 million directly from Iran through Saderat. Iran and Hizballah also use Saderat to transfer money to other designated terrorist groups, such as Hamas, the PFLP-GC, and the Palestinian Islamic Jihad.

Treasury has also utilized Executive Order 13224 to target Iran's terrorist support networks. This Executive Order, issued immediately after September 11 attacks, has proven to be a powerful and flexible tool—it allows us to designate and block the assets of individuals and entities controlled by, or acting on behalf of, or providing support to named terrorist organizations, freezing any of the target's assets that are held by U.S. persons and preventing U.S. persons from having any future dealings with them. To date, the United States has designated approximately 460 individuals and entities pursuant to E.O. 13224. We have used this tool, in close coordination with colleagues in Departments of State and Justice, to expose and disrupt the financial networks of terrorist groups including al Qaida, Hizballah, Hamas, Jemmah Isalmiyya, and the GSPC, and to designate financiers and supporters in Southeast Asia, the Persian Gulf, the Horn of Africa, South America's Tri-Border Area, Europe, and the United States.

#### *Engaging the Financial Community*

In concert with the targeted measures we have taken, Treasury has engaged in unprecedented, high-level outreach to the international private sector that is focused on the potential for abuse of the financial system by Iran. Treasury officials have met with more than 40 banks worldwide to discuss the threat Iran poses to the

international financial system and to their institutions. Secretary Paulson kicked off this effort last fall in Singapore, in discussions during the annual IMF/World Bank meetings, where he met with the executives from major banks throughout Europe, the Middle East, and Asia. Secretary Paulson, Deputy Secretary Kimmitt, Under Secretary Stuart Levey, and Assistant Secretary Patrick O'Brien have continued to engage with these institutions abroad, as well as in Washington and New York.

Through this outreach, we have shared information about Iran's deceptive financial behavior and raised awareness about the high financial and reputational risk associated with doing business with Iran. We share common interests and objectives with the financial community when it comes to dealing with threats to the financial system. Financial institutions want to identify and avoid dangerous or risky customers who could harm their reputations and business. And we want to isolate those actors and prevent them from abusing the financial system.

By partnering with the private sector, including by sharing information and concerns with financial institutions, we are increasingly seeing less of a tendency to work around sanctions. We are finding that even those institutions that are not formally bound to follow U.S. law pay close attention to our targeted actions and often adjust their business activities accordingly, primarily for two reasons. First, most bankers truly want to avoid facilitating proliferation, terrorism, or crime. These are responsible corporate citizens. Second, avoiding government-identified risks is simply good business. Banks need to manage risk in order to preserve their corporate reputations. Keeping a few customers that we have identified as terrorists, terrorist supporters, or proliferators and their supporters is not worth the risk of facing public scrutiny or a regulatory action that may impact on their ability to do business with the United States or the responsible international financial community.

As evidence of Iran's deceptive practices has mounted, financial institutions and other companies worldwide have begun to reevaluate their business relationships with Tehran. Many leading financial institutions have either scaled back dramatically or even terminated their Iran-related business entirely. They have done so of their own accord, many concluding that they did not wish to be the banker for a regime that deliberately conceals the nature of its dangerous and illicit business. It has been reported that many global financial institutions, have curbed dealings with Iran. In addition to complying with the global sanctions imposed against Bank Sepah through UN Security Council Resolution 1747, certain foreign banks have also stopped handling dollar transactions for Saderat, forcing Saderat to conduct its foreign exchange transactions in euros. Regardless of the currency, the core risk with Iranian business—that you simply cannot be sure that the party with whom you are dealing is not connected to some form of illicit activity—remains the same. Scaling back dollar-business reduces, but does not eliminate, the risk.

As further evidence of the change in tide, a number of foreign banks are refusing to issue new letters of credit to Iranian businesses. And in early 2006, the OECD raised the risk rating of Iran, reflecting this shift in perceptions and sending a message to those institutions that have not yet reconsidered their stance. Additionally, many other companies have scaled back on their investments or projects in Iran, concluding that the risks of expanding operations in the country are too great. Multinational corporations have held back from investing in Iran, including limiting investment in Iran's oil field development. These companies have done their risk analyses, and they have realized that the Iranian regime's behavior makes it impossible to know what lies ahead in terms of Iran's future and stability. All of these developments have a mutually-reinforcing effect, producing a worldwide reevaluation of dealings with Iran.

This extensive and innovative private sector outreach, combined with our targeted sanctions and other diplomatic efforts of the U.S. Government, has paved the way for international pressure on the Iranian regime to stop its illicit activities. International partners who originally resisted the idea of applying pressure to Iran have reversed this position and now support pressuring the Iranian regime to renounce its support for terrorism and WMD proliferation and to comply with its international obligations. This reversal only occurred through balanced and targeted sanctions against Iran, coupled with strong and persistent diplomacy.

#### *United Nations Security Council Resolutions 1737 and 1747*

The impact of these efforts has been amplified and reinforced with the passage of UN Security Council Resolutions 1737 and 1747. Thanks to the tireless efforts of our State Department and other concerned countries, the UN Security Council unanimously passed Resolution 1737 on December 23, 2006, requiring governments worldwide to take steps to combat Iran's illicit activities, including freezing the assets of named entities and individuals associated with Iran's nuclear and missile programs, as well as the assets of entities owned or controlled by them. The resolu-

tion also requires states to prevent the provision to Iran of any financial assistance, or the transfer of any financial resources or services, related to the supply, sale, transfer, manufacture, or use of prohibited items associated with Iran's nuclear and missile programs. Several of the entities named in UN Security Resolution 1737, including the AEOI, SBIG, SHIG, Mesbah Energy Company, and Kalaye Electric Company, have already been designated by the United States.

UN Security Council Resolution 1747, unanimously adopted on March 24, 2007, builds upon the asset-freezing provisions found in UN Security Resolution 1737. The new resolution identifies additional Iranian entities and individuals for designation, some of which have already been publicly designated by the Treasury Department. Significantly, among these entities was Bank Sepah.

### III. SAFEGUARDING THE FINANCIAL SYSTEM FROM TERRORISM AND WMD PROLIFERATION THREATS BY IDENTIFYING AND CLOSING VULNERABILITIES

In addition to disrupting and dismantling the financial networks that support terrorists and WMD proliferators through the use of targeted economic sanctions, Treasury has used its authorities to safeguard the domestic and international financial system from abuse by identifying and closing vulnerabilities that criminal organizations, terrorist organizations and their state sponsors, and WMD proliferators and their supporters could exploit. In the process, we have degraded the ability of state sponsors of terror and proliferators to access the international and U.S. financial system. In administering earlier economic sanctions programs, and more recently with respect to terrorist groups and WMD, we have worked with our interagency partners, international counterparts and directly with the private sector to advance this fundamental interest by pursuing a number of strategies, including:

- identifying typologies of terrorist and illicit financing that present systemic threats to the domestic and international financial system;
- strengthening and expanding international standards to address these vulnerabilities and to enhance transparency across the international financial system;
- facilitating compliance with international standards through comprehensive international anti-money laundering/counter-terrorist financing (AML/CFT) assessments and technical assistance;
- taking appropriate protective actions against those jurisdictions and financial institutions whose AML/CFT and enforcement deficiencies represent substantial threats to the domestic and international financial system; and
- conducting private sector outreach to the international banking and other financial service industries.

This comprehensive strategic approach, described in greater detail below, safeguards the financial system from abuse by effectively promoting transparency, particularly across those higher risk elements of the financial system. Such transparency in the financial system is essential in allowing financial institutions, law enforcement, regulatory and other authorities to identify sources and conduits of illicit finance, as well as those individuals and entities that comprise terrorist, WMD and criminal support networks.

Identifying such illicit behavior and terrorist and criminal support networks allows financial institutions and government authorities to adopt appropriate protective measures to prevent these nefarious elements from corroding the financial system. In turn, protective measures deny them access to the financial system, forcing terrorist organizations and proliferators and their supporters to adopt alternative financing mechanisms and support structures that present higher costs and greater risks. Finally, the transparency created by our systemic efforts to protect the financial system from abuse is an essential pre-condition for developing and applying targeted financial measures to attack and disrupt specific threats to our national security, foreign policy and criminal justice interests.

#### *Strengthening and Expanding International AML/CFT Standards*

Because of the growing international nature of the financial system, we must work continuously with other financial centers around the world to establish and maintain effective international standards to protect the international financial system from various sources and conduits of illicit financing. In coordination with the interagency community, Treasury primarily advances this strategic objective through the Financial Action Task Force (FATF), and also supports the progressive development of international standards against terrorist and illicit financing at the United Nations (UN).

The FATF sets the global standard for combating terrorist financing and money laundering and provides us with a unique opportunity to engage our international counterparts in this effort. Treasury—along with our partners at State, Justice, Homeland Security, the Federal Reserve Board, and the Securities Exchange Commission—continues to assume an active leadership role in the FATF, which articulates standards in the form of recommendations, guidelines, and best practices. These standards aid countries in developing their own specific anti-money laundering and counter-terrorist financing laws and regulations that protect the international financial system from abuse.

Since before the terrorist attacks of September 11, 2001, we have consistently engaged the FATF to expand and strengthen these international standards to address the systemic vulnerabilities that terrorists and other criminals exploit, including through the development of Nine Special Recommendations on Terrorist Financing and the revision and strengthening of the FATF 40 Recommendations. Most recently, we have successfully engaged the FATF to adopt a new international standard to combat the illicit use of cash couriers, and we have enhanced the international standard for combating terrorist abuse of charities. We have also recently finalized a number of technical but critical aspects to the international standard governing the availability and integrity of originator information on cross-border wire transfers.

*Reinforcing AML/CFT Framework to Isolate WMD Proliferators and their Support Networks*

In February, we launched a discussion within the FATF of how the existing Anti-Money Laundering/Counter-Terrorist Financing (AML/CFT) international standards should be supplemented, amended or applied to address the vulnerabilities associated with WMD proliferation finance. Although there are a number of long-standing instruments and organizations to prevent and counter the proliferation of WMD, their means of delivery and related materials, as well as numerous export control regimes, there is a lack of international focus and no international standards related to preventing financing of illicit proliferation activity and to isolating WMD proliferators from the international financial system. A FATF working group charged with matters related to terrorist financing and money laundering decided in February to hold a special session in May to discuss the issue of proliferation finance, and to consider whether the FATF should adopt guidance to assist countries in their efforts to counter WMD proliferation finance. This urgent work will focus, in particular, on guidance for countries on the implementation of sanctions and finance-related provisions in a growing number of UN Security Council Resolutions related to proliferation activities in North Korea and Iran, as well as the threat of non-State actors' ability to procure and use WMD. In addition, we will explore in the FATF the broader potential of applying the existing framework of the AML/CFT international standards against WMD proliferation finance, beginning with a focus on "typologies" to better understand the nature of this threat. This study will provide the foundation for a broad assessment of the types of actions countries could take to isolate WMD proliferators from the financial system.

These standard-setting efforts at the FATF create an international obligation and framework for countries to implement AML/CFT regimes that promote transparency and effectively protect the international financial system from various forms of illicit finance, including terrorist financing and WMD proliferation finance. This framework provides a basis for multilateral consideration of additional ways that we can effectively degrade WMD proliferators' ability to access and use the financial system, crippling their ability to finance their pursuit of WMD.

*Taking Protective Action against Systemic Vulnerabilities*

In those instances where jurisdictional or institutional deficiencies present ongoing systemic vulnerabilities that create substantial money laundering or terrorist financing threats to the international financial system, Treasury can take appropriate protective action under Section 311 of the USA PATRIOT Act. Section 311 authorizes Treasury to designate a foreign jurisdiction, foreign financial institution, type of account or class of transactions as a primary money laundering concern, thereby enabling Treasury to impose any one or combination of a range of special measures that U.S. financial institutions must take to protect against illicit financing risks associated with the designated target. These special measures range from enhanced due diligence, recordkeeping, and reporting requirements up to and including termination of any and all correspondent accounts or activities with the designated target.

Congress granted Treasury this powerful and flexible authority which has been utilized in a variety of ways to protect the U.S. financial system from money laun-

dering and terrorist financing threats associated with three foreign jurisdictions and eight foreign financial institutions. On each of these occasions, our Section 311 designation has had a significant effect in protecting not only the U.S. financial system, but also the international financial system, as international financial institutions have taken independent protective financial actions in response to the systemic vulnerabilities associated with the designated target. In some instances, designation under Section 311 has even facilitated the development of rehabilitative measures that effectively addressed the underlying systemic vulnerability such that withdrawal of the 311 designation has been warranted.

*Case Study: Banco Delta Asia*

The most well-known example of Treasury's use of Section 311 is the designation of the Macau-based Banco Delta Asia (BDA) as a primary money laundering concern in September 2005. At that time, Treasury issued a proposed rule, which was finalized last month, prohibiting U.S. financial institutions from opening or maintaining correspondent accounts for or on behalf of BDA. Treasury took this step to protect the U.S. financial system from BDA because of the bank's systemic failures to apply appropriate standards and due diligence, as well as its facilitation of unusual or deceptive financial practices by North Korean-related clients. These concerns were subsequently confirmed by an in-depth, 18-month-long investigation of BDA conducted with the cooperation of the Macanese authorities.

Abuses at the bank included the facilitation of several North Korean-related front companies that may have laundered hundreds of millions of dollars in cash through the bank. The final rule highlights the bank's grossly inadequate due diligence, which facilitated deceptive financial practices by these clients including:

- Suppressing the identity and location of originators of transactions and arranging for funds transfers via third parties;
- Repeated bank transfers of large, round-figure sums both to and from accounts held at other banks that have no apparent licit purpose; and
- The routine use of cash couriers to move large amounts of currency, usually U.S. dollars, in the absence of any credible explanation of the origin or purpose for the cash transactions.
- The provision of intermediary financial services on behalf of North Korean banks by two related business accountholders, which accounted for more than 30 percent of the bank's bulk cash turnover over a multiple year period. These services were provided at least in part to disguise the origins of the transactions. Bank documents reveal that Banco Delta Asia had knowledge of the relationships between the banks and these entities, willingly obscured the identity of the transacting institutions, and agreed to continue treating the accounts as business accounts, not banking accounts, despite activity consistent with banking.

In addition to protecting the U.S. financial system from the significant vulnerability that BDA represents, the Section 311 action has spurred improvements in Macau's regulatory environment. Following the BDA action, the Macanese authorities took substantial steps to strengthen Macau's anti-money laundering and counter-terrorist financing regime, notably by passing a new law to strengthen these controls and standing up the jurisdiction's first-ever Financial Intelligence Unit (FIU).

Perhaps most importantly, the action against BDA has had a profound effect, not only in protecting the U.S. financial system from abuse, but also in notifying financial institutions and jurisdictions globally of an illicit finance risk.

BDA is not, however, the only example of the strategic application of Section 311 by the Treasury Department. Section 311 also has been used, in combination with other authorities, to address the threat that Syria's problematic behavior poses to the United States. In addition to the use of targeted economic sanctions against Syrian entities involved in WMD proliferation, Treasury has taken action under Section 311 to protect the U.S. financial system against the Commercial Bank of Syria (CBS), which has been used by criminals and terrorists to facilitate or promote money laundering and terrorist financing, including the laundering of proceeds from the illicit sale of Iraqi oil and the channeling of funds to terrorists and terrorist financiers. In March 2006, Treasury issued a final rule, pursuant to Section 311, designating CBS as a primary money laundering concern and requiring U.S. financial institutions to close correspondent relationships with CBS. Consequently, prominent international financial institutions have begun to reassess their relationships with Syria and a number of Syrian entities.

#### *Conducting Private Sector Outreach*

In addition to the targeted economic sanctions and protective measures discussed above, Treasury has launched a comprehensive outreach campaign that includes efforts to educate the private sector about the potential for abuse by terrorists, state sponsors of terror and WMD proliferators.

Treasury launched this international private sector outreach effort by initiating private sector AML/CFT dialogues linking the U.S. banking sector together with those from the Middle East/North Africa (MENA) region and the Latin American region, with the support of relevant financial and regulatory authorities. The purpose of these dialogues is to:

- raise awareness of domestic and regional money laundering and terrorist financing risks, international AML/CFT standards and regional developments, and U.S. government policies and private sector measures to combat terrorist financing and money laundering;
- assess the impact of AML/CFT international standards and U.S. law and regulation on AML/CFT development and implementation in the U.S. and foreign banking and financial service industries; and
- strengthen development and implementation of effective AML / CFT measures, particularly in regions of strategic importance and jurisdictions that lack fully-functional AML/CFT regimes.

In collaboration with its interagency and regional partners, Treasury successfully facilitated the launch of the U.S.-MENA Private Sector Dialogue on AML/CFT with an initial AML/CFT Conference in Cairo in March 2006. Bankers and financial and regulatory authorities from the U.S. and the region discussed a range of challenges associated with the development and implementation of effective AML/CFT jurisdictional and institutional measures. A follow-on conference at the Federal Reserve Bank of New York in December 2006 was equally successful.

Treasury has initiated a similar dialogue with the Latin American banking community, hosting a roundtable discussion of U.S. and regional interests at Treasury in June 2006 to help frame this initiative. Based on this roundtable discussion, Treasury assisted in organizing an inaugural United States-Latin America Private Sector Dialogue conference on AML/CFT in Bogota, Colombia last week. Private sector participants and regulators from both regions participated in the conference, where challenges in AML/CFT implementation were discussed.

This direct private sector outreach to the international financial community complements our other work to address vulnerabilities in the international financial system by providing a mechanism to explain our money laundering and terrorist financing concerns, assess and facilitate AML/CFT progress and implementation, and receive feedback on the effectiveness of our efforts from key regional participants in the international financial system.

#### *Encouraging Multilateral Action*

A significant part of Treasury's mission is also devoted to U.S. government efforts to secure international support and implementation of targeted economic sanctions and financial actions like those we have described. As we noted above, the effectiveness of these authorities is significantly enhanced when other countries support U.S. efforts by freezing terrorist assets in their own jurisdictions, and prohibiting their nationals from dealing with terrorists. In coordination with the Department of State, Treasury facilitates such action through a variety of activities, including by maintaining a dialogue with other countries regarding the financial actions that are needed to disrupt specific terrorist cells or networks. However, we are also working to strengthen other countries' capacity and ability to implement targeted economic sanctions.

Through the U.S. government's efforts with the European Union, the Financial Action Task Force, the G7 and others, we have succeeded in assisting other countries to develop national sanctions authorities similar to our own and to improve cooperation in implementing effective sanctions regimes. In many cases, countries have joined us in imposing sanctions on U.S.-designated individuals and entities, either independently or through action at the UN. We have seen an increase in the number of countries approaching the UN Security Council to seek the designation of terrorist supporters. This global designation program, overseen by the UN's 1267 Committee, is a powerful tool for global action against supporters of al Qaida and the Taliban. It envisages 191 UN Member States acting as one to isolate al Qaida's supporters, both physically and financially.

On the WMD proliferation front, the U.S. has taken initial steps to implement UNSCR 1540, UNSCR 1695, UNSCR 1718, UNSCR 1737 and 1747, but many coun-

tries have not. Treasury, in conjunction with the State Department and other agencies, has begun outreach initiatives on a variety of fronts to encourage other countries to fulfill these international obligations by developing and utilizing authorities similar to E.O. 13382 in their own jurisdictions. Alternatively, we are urging countries to consider how they may be able to use existing authorities to freeze WMD proliferators' assets and prohibit their nationals from having dealings with them. In addition to the initiative within the FATF discussed above, Treasury is working in a variety of fora to encourage additional attention to the problem of WMD proliferation finance:

- *G-7.* Treasury and State are engaging with G-7 Financial Experts counterparts to discuss the issue of WMD proliferation finance and determine what can be done to isolate WMD proliferators from the international financial system through multilateral action. The G7 was unified in its endorsement of the recent initiative to launch discussions of proliferation finance within the FATF. The G-7 Finance Ministers last week issued a statement commending the FATF on its commitment to examine the risks of weapons of mass destruction proliferation finance and calling for effective and timely implementation by countries of Chapter VII UNSCRs 1540, 1718, 1737 and 1747.
- *Proliferation Security Initiative.* Treasury is working with the State Department to encourage the more than 70 countries that participate in the Proliferation Security Initiative (PSI) to use financial measures to combat proliferation support networks. This initiative, which was established by the President in May 2003, aims to stop shipments of weapons of mass destruction, their delivery systems, and related materials worldwide. Treasury officials attended the PSI's High Level Proliferation Meeting in Warsaw, Poland in late June 2006 and were encouraged by the strong response to the U.S.-led discussion of ways in which countries could address the financial underpinnings of WMD proliferation. We plan to tap into the proliferation-related expertise the PSI's Operational Experts Group (OEG) offers as we study WMD proliferation finance within the FATF, and will keep the OEG informed of the steps we are taking to develop standards and best practices to counter the threat of WMD proliferation finance.
- *Global Initiative.* We will also work with the State Department support activities associated with the Global Initiative to Combat Nuclear Terrorism, announced by President Bush and President Putin in July. This initiative goes to the heart of the threat that is most concerning—the possibility that nuclear weapons could fall into the hands of terrorists—and opens up new possibilities for the effective use of financial authorities.

#### IV. CONCLUSION

Treasury—working closely with the State Department and the rest of the interagency—is playing an integral role in the Administration's strategy to combat proliferation and terrorism. Our use of targeted financial measures to safeguard the U.S. financial system, along with outreach to the private sector, are indeed having an impact, particularly on the ability of Iran and North Korea to misuse the financial system to carry out their dangerous activities. Together with my colleagues at this table and throughout the government, we will continue to employ all of our resources and authorities to keep our country safe.

I look forward to working closely with you, other members of the Subcommittees, and your staff on these important issues. Thank you again for the opportunity to testify today.

Mr. SHERMAN. Thank you. I want to thank all the witnesses here not only for their presentation but for their hard work day-to-day, but let us not kid ourselves. We have not yet changed the behavior of Iran or Sudan, and we have not used but the little finger of our ability to impose sanctions because every time the slightest peep of opposition comes from any even moderately powerful entity here in the United States, we back off. My best example is that the epicureans do not want to survive without Iranian caviar, and if our nonproliferation policy must bow down to the power of epicureans here in Washington, you can imagine how we react when the oil companies object to policy.

Perhaps the best example of how we react to the power of oil companies here in the United States lays the basis for a question I will ask Mr. Simons. We have passed the Iran-Libya Sanctions Act, worked against Libya because we actually applied it, yet neither administration was willing to apply it with regard to investments in Iran. As part of my written opening statement, I have entered into the record a chart prepared by CRS that lists hundreds of billions of dollars or tens of billions of dollars of investments made in the Iranian oil sector. Most of these are not secret. CRS does not have classified information. In fact, most of these investments were reported official to shareholders and in the financial press.

The attitude of the State Department tends to be that if Congress passes a law, and you think it is bad policy, you just ignore the law. I am not sure the constitutional scholars agree that that ought to be the approach. Is it your position that you are simply unaware of any oil company that has made a \$20 million investment in the Iranian oil sector, or is it your position that you just do not have to follow the law?

Mr. SIMONS. Thank you, Mr. Chairman, for that question, and I will do my best to clarify the administration position on this. Let me state up front that the administration was very involved last year—

Mr. SHERMAN. Sir, I will ask you to address the question extremely briefly. We have very little time.

Mr. SIMONS. Thank you. Point number one, the administration was very actively involved with Congress last year in reauthorizing the Iran Sanctions Act for an additional 5 years.

Mr. SHERMAN. They have ignored it the last 5 years. They will continue to ignore it. The question is not: Do you allow it to become law? The question is: Why do you not follow the law?

Mr. SIMONS. Second point we have utilized diplomacy very actively, and utilized the law in high level demarches around the world with our major partners.

Mr. SHERMAN. The law does not provide for high level demarches. The statute says you acknowledge and publicize the fact that the oil company made the investment, and then you either waive or impose sanctions. Do you have to follow the law, or just kind of use it the way you want to?

Mr. SIMONS. Well with respect to how we specifically look at the administration of the law, I think it is important to—

Mr. SHERMAN. Sir, I asked you a very specific question. Is it your position that no oil company has made a \$20 million investment in Iran since the Act became law? Yes or no?

Mr. SIMONS. Mr. Chairman, the pace of investment in Iranian oil sector has gone down considerably over the past 3 years.

Mr. SHERMAN. Yes. Has there been a \$20 million investment, or do you just not want to answer the question?

Mr. SIMONS. We believe that the pace of investment in Iran oil sector has gone down considerably.

Mr. SHERMAN. Has there been a \$20 million investment, or are you going to filibuster? This is not the Senate.

Mr. SIMONS. Well, Mr. Chairman, I am trying to explain. I am trying to give the best possible answer.

Mr. SHERMAN. I asked yes or no. Has there been a \$20 million investment? Are you going to answer the question or not?

Mr. SIMONS. I am going to explain it to the best of my ability.

Mr. SHERMAN. In other words, you are not going to answer the question. I will move on to our friends from Treasury. Treasury has jurisdiction over U.S. membership in the World Bank. Which is the bigger problem, the fact that the World Bank distributed \$193,500 to Mr. Wolfowitz's friend, or the fact that since Mr. Wolfowitz is there it has disbursed over \$400 million to the government in Tehran? Mr. Szubin or Mr. Glaser?

Mr. SZUBIN. I am not an expert on the World Bank issues but what I can say is to the extent I am familiar with the assistance they have extended to Iran it is primarily for humanitarian and development purposes which is not going towards—

Mr. SHERMAN. Let me interrupt. We are all politicians here. We know something about how a government stays in power. You stay in power by bringing home the pork. Now I know it is not Halal. It is not kosher but it is pork, and when you allow Iranian officials to cut the ribbons on giant projects in northern cities in Iran, you help that government stay in power. Now with that in mind, what has Treasury done to prevent the disbursement of over \$400 million, roughly a quarter of it our tax dollars, to help the Government of Iran stay in power?

Mr. SZUBIN. I really should be cautious here. My understanding is that the U.S. has opposed these votes but let me take the—

Mr. SHERMAN. The U.S. has opposed in the most quiet words possible and only because statute—which at least your Department technically follows—requires them to vote “no,” but they have done nothing to the World Bank over this, and they still ask us to appropriate and reauthorize as if nothing ever happened. I see that my time has expired. I will ask the State to respond for the record as to why we are still importing \$170 million worth of goods from Iran every year, not oil, but just the stuff that we do not need, and they could not sell anywhere else. I now recognize the gentleman from Texas, Mr. Paul.

Mr. PAUL. Thank you, Mr. Chairman. I have a question I think Mr. Szubin can be the individual to answer this but anybody can respond, and it has to do with sanctions in general. You know there is pretty good evidence that sanctions do not work. I mean when we talk about Cuba they go on and on and on, and you know these are my arguments that it is not a very good idea, and other countries as well that it has not really worked.

And the other part of the argument is that it solidified power. It actually helps the dictators rather than hurts them because they can have a scapegoat, and it also insights strong nationalistic spirit in those countries, and it unifies the country and actually diminishes any chance of dissent from those people who want to undermine the government that we are trying to undermine.

So it actually does the opposite of what we want, and too often the citizens get injured and not the dictators. That certainly happened for 10 years with Iraq. You know it was admitted that 500,000 children may have died from those sanctions, and yet Saddam Hussein until he was taken out the sanctions really did not hurt him. And also the argument that there is injury to our export-

ers too. Obviously you know we cut off exports our people suffer. I have farmers in my district and there are countries that they used to export to. They could export to Cuba.

So we injure ourselves too if we do not achieve our goals. These are all the arguments from us who object on principal against sanctions. But what I would like to know is do you deny all these things that we argue or do you sort of say, well yes, you know that is partially true, but those are the acceptable costs? What would you answer to that question?

Mr. SZUBIN. Thank you for the question. I think it goes right to the core of what we are considering constantly when we think about how to apply sanctions in a smart and effective way, and the concerns about unintended consequences that you raise, the concerns about hurting the people of a country when it is really the regime's behavior that we are trying to change, are things that we look at very carefully in how we craft—working with the State Department—how we craft the dimensions of our sanctions.

I can give you some examples of that. With respect to Iran, I think we can document some real successes in terms of applying pressure against the Iranian regime. The example of Bank Sepah which I gave you is really remarkable, and I do not know if it is fully understood outside of the U.S. Government where you have one of the largest banks in Iran all of a sudden facing a worldwide, basically a worldwide ban.

If you think that is something that the Iranian Government shrugs off, I can tell you they do not. They take that very seriously, and the fact that all around the world countries are reducing export credits saying we are not so comfortable with trade with this country. The fact that countries around the world are beginning to say, we are going to cut off all dealings with you and banks are beginning to say, we are not going to handle your business, it has made an enormous difference in North Korea and in Iran. It is shaking them, and if it is not shaking the Ahmadinejads of the world, it is certainly making the elites of that country think: "Is this the direction we want our country to be going in?"

Mr. PAUL. May I interrupt because I think we are not getting to the point of my question, and that is do you think some of my concerns are real or do you just say well that is not true or that is just part of the problem and part of the cost, and we have to accept that or are you arguing the case for sanctions being effectively applied and working okay? Does that mean you deny that my concerns are ever something that we should be talking about?

Mr. SZUBIN. No, no, not at all. I think to the contrary. I think it is your concerns exactly that have informed our approach to sanctions. In other words, how can we apply sanctions in a way that take into account the concerns you are raising? That try to avoid unintended consequences? That try to avoid having the people of a country as you say feel like they resist the application of sanctions more than their own oppressive governments? And so that is why we have been so careful to be targeted.

Mr. PAUL. Excuse me. So you are in a way arguing that if you apply them more wisely you are going to avoid these consequences which I guess if that is the case, I think that it might be a dream but that is what you think your goal is is to—

Mr. SZUBIN. That is our goal, and I do not want to overstate our successes or underplay the costs that come with sanctions. They do come with costs. What we try to do is minimize them, and so we cannot avoid them all together but if they are going to be effective, they are going to deliver costs and some unintended consequences. We try to minimize them and be smart about them.

Mr. PAUL. Okay. And I yield back.

Mr. SHERMAN. Thank you. I will now yield to Mr. Scott, the vice chair of our committee.

Mr. SCOTT. Thank you very much, Mr. Chairman. I would like to start my question with how much of an obstacle in each of your opinion is Russia to this process of sanctions working in Iran?

Ms. MCNERNEY. Well this last resolution we worked actually quite closely with Russia in terms of crafting Security Council Resolution 1747. We do have concerns, and I think we have expressed them publicly as well as to the Russians privately at many levels with their arms relationship that remains with Iran. We have expressed concerns about the Bashehr reactor, although Russia has delayed finalizing that, and delayed the shipment of fuel as a result of concerns they have as well.

I think Russia is a key player as is China in a sanctions program that works from a multilateral standpoint, and to the degree that Russia steps up and increases its pressure, I think that is a very important element of our overall effective sanctions regime.

Mr. SCOTT. Mr. Simons?

Mr. SIMONS. Perhaps if I could just add one point that Under Secretary Burns raised when he was up here on the Hill several times in the last few weeks which is that we are really at a different starting point from the rest of the world with respect to sanctions on Iran. We have had unilateral sanctions in place for 29 years. The rest of the world has generally had open trade and investment regime with Iran including arms sales in certain cases, and to bring the rest of the world around to our way of thinking has been a huge challenge but we think we have had a fair amount of success since we started down this path 2 years ago.

We now have two consecutive Chapter VII resolutions. We have language in the most recent resolution calling for a review of export credits. We are moving along on designations of individuals and entities involved in nonproliferation. This was really quite unthinkable a couple of years ago. So you really have to I think keep in mind that we are operating from different starting points, and we are bringing the entire rest of the world along, and this requires a certain amount of patient diplomacy. Thank you.

Mr. SCOTT. Mr. Glaser?

Mr. GLASER. Well, certainly our interaction with our Russian counterparts has been more limited than in the State Department context. In our direction with Russia on anti-money laundering, counterterrorist financing issues, I think we enjoy a very close relationship with Russia both in the financial action task force and in our bilateral cooperation. Russia has a very, very large financial system. They have over 1,000 banks in Russia, and certainly we have discussed with our Russian counterparts concerns relating to the ability of illicit actors, Iran, North Korea, to access some of those banks.

That is something we are going to continue to work on with Russia but overall from a Treasury Department perspective and our cooperation with Russia in anti-money laundering and counterterrorist financing issues, I think that we have enjoyed a close cooperation.

Mr. SCOTT. Well let me ask you: How do you account for it if Iran says they are not going ahead with their nuclear program for a nuclear weapon, they are going forward for nuclear energy? The one fact that looms out to us that says that might not be so is the quantity of what is called fissile material which is the most critical component that goes the other way, and we have learned that Russia has been the source of this.

You all seem to from your comments seem to treat Russia as being a rather benevolent friend here but on that point alone it says that we have got some serious back channeling we need to do with Russia, and I am concerned that we are not doing enough of that. That we are not having the kinds of talks with these folks. I mean you are saying one thing but that evidence.

Then the second point was at the basic the same time that the administration made the move to send two carrier units into the Gulf was at the point where the decision was made for the \$750 million anti-aircraft defense mechanism that Russia has sold to Iran. And it seems to me that I do not believe that this country is putting enough emphasis on Russia in terms of what they have got to do. And I see my time is moving on but my point is that given all of that, what more do you think we can do in terms of incentives to get Russia to really play ball with the rest of the world and particularly with us to effectively deal and negate this threat in Iran because it is clear from what I have just said and information that they are the main culprit of getting them in the position of being the threat that they are.

Ms. MCNERNEY. I will take that. Well I think that there is a distinction there with the Bashehr reactor, which we have been concerned that Russia obviously has cooperated, but what is of particular concern and the focus of the IAEA as well as the U.N. Security Council is the uranium enrichment program. There we do not have information that Russia has been engaged in support for that program, which raises the most concern relating to its nuclear weapons application.

At the same time you are correct that it is essential that Russia be a party to any multilateral action to put pressure on Iran. I do think we have made progress in that regard. Russia looks at these problems differently. We obviously have a lot of work to convince them to look at the threat the way we do. There are larger regional context that are part of any dialogue we have with Russia, but certainly at the highest level there is regular contact. There is regular dialogue, and I think the fact that all of the Security Council resolutions have been adopted unanimously is an indication of Russia's role in putting the pressure on Iran in a way that they view as sufficient. But obviously we would like to increase that pressure.

Mr. SHERMAN. Thank you. I believe the gentleman's time has expired. I notice an extraordinary interest of Japanese media in these hearings and glad for it. I will point out that as in my written opening statement made part of this record, the Impex Company

of Japan has made a \$200 million investment in the Iranian oil fields. They entered into that transaction in February 2004, and in response to Mr. Scott's comments, I should point out that I have talked to everyone in the administration from the President to Secretary Rice, urging that we recalibrate all of our policy toward Russia as necessary to secure their definitive support on proliferation and other issues, particularly Iran.

Unfortunately, they are not interested in changing any part of our policy toward Russia on, say, issues in Russia's backyard in order to get Russia to change its policy toward Iran. Now I would like to recognize our ranking member, Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman. North Korea has been counterfeiting United States currency, and it has been reported that recent discussions with the North Koreans in addition to seeking an end to action against Banco Delta Asia, they wanted a shipment of counterfeit currency detectors supposedly to keep notes from entering their system, and this struck me as rather amazing because I wonder if it is plausible.

I wonder if it is more likely that they wanted this technology to help them better defeat countermeasures we are taking to protect our currency. So based upon what they used equipment that they purchased abroad for in the past, I just thought I would ask that question since they are entertaining that requesting that from us.

Mr. GLASER. Well, thank you, Mr. Royce, and you are correct. That was a discussion that was had in the context of the bilateral working group that I am involved with, with North Korea, and you are exactly right. We do continue to remain concerned about ongoing counterfeiting by the Government of North Korea, and this is something that we take quite seriously. In my last working group with North Korea, I brought two senior U.S. Secret Service agents, investigative agents, with me to discuss those concerns and to raise those concerns, and it is something that we are going to continue to go back to until the practice is stopped.

Mr. ROYCE. Yes, but my question was just the ludicrous nature of a request from the other side of the table for this technology of us which would allow them then to avoid countermeasures. Let me ask you another question here. The Treasury Department's designation of Bank Sepah in Iran revealed a financial relationship. When you designated that you revealed a financial relationship between Iran and North Korea as Bank Sepah was facilitating business between Iran's aerospace industries organization and North Korea's chief ballistic missile related exporter at the time.

North Korea has a longstanding missile relationship with Iran. So I was going to ask how comprehensive is the North Korea/Iran relationship, and I was also going to ask you the Treasury Department has implemented targeted measures against two Iranian state-owned banks, Bank Saderat for financing Hezbollah in 2006, and the bank I just mentioned in January for its ties to Iran's proliferation activity. What degree of the financial sector in Iran, the banking sector, is state owned because we have moved here on two of their state-owned banks but the four largest state-owned banks I assume are also critical in Iran's drive to acquire WMD, and I would assume actions should be taken against them too given the

attitude of the regime and the use that they put to state-owned parastatels like this.

Mr. GLASER. Well to address your second question first, I do not have any numbers off the top of my head. A substantial portion, if not all of the Iranian banking sectors, is state owned and controlled. We have taken very important action against two Iranian banks, Bank Saderat and Bank Sepah. In the case of Bank Saderat, as you note for terrorist financing concerns—

Mr. ROYCE. Listen. I concur with that. I am asking you about the four largest banks, moving on them on the basis of what we have found state-owned banks doing where we have proved these other two cases.

Mr. GLASER. What we are trying to do is have a strategic and growing momentum with respect to how we approach Iran and Iran's activity in the international financial system.

Mr. ROYCE. Okay.

Mr. GLASER. This combines a lot of efforts. It combines all of our tools. In the case of Bank Sepah, we used an Executive Order. In the case of Bank Saderat, it was a revocation of the U-turn license, and we are combining that all with strategic dialogue with the international private sector. We are also combining that with multilateral work with the U.N. I think as we move forward you will see that we are going to continue to focus on the Iranian financial system, and we are going to continue to try to squeeze it, and to try to make sure that these—

Mr. ROYCE. All right. But while you are sending that message, let me just close with this. In releasing \$25 million to North Koreans, money they had in Banco Delta Asia, did we return to them ill-gotten gains? Funds produced through counterfeiting, drug running and other illegal activity? Is it not true that we returned those funds to them?

Mr. GLASER. Well we did not return anything to North Korea. It was not North Korea's money, and it was not our money. It was money frozen by the Macaunese authorities and it belonged to account holders who were certainly North Korean related. Several of these account holders we certainly do have concerns about.

I think the broader question as you yourself pointed out, Mr. Royce, is how effective was our action with respect to Banco Delta Asia in closing a vulnerability in the international financial system, and communicating to North Korea that we will not tolerate this type of activity, and frankly communicating to Iran and communicating to all bad actors, and I think we have done that with the way we have gone final on our rule and with the way we continue to monitor the international financial system.

Mr. ROYCE. Yes. We were influential but my question was: Was ill-gotten dollars returned? Was ill-gotten gains returned to North Korea?

Mr. GLASER. Right. I understand what you are saying, and I think it is a more complicated question than that. These are not our funds, and they are not North Korea's funds. I spent 2 weeks in Beijing working with all interested parties, working with the Macaunese, working with the Chinese, working with the North Koreans and working with the South Koreans to try to find the best way to dispose of these funds.

In the end, it is not a question of whether I am happy about the resolution, whether I am comfortable with the resolution. The question is what was the most workable resolution? What was a workable resolution? It was never our intention that these funds be frozen indefinitely, and in the end, the workable resolution was that the funds be returned to the account holders.

Mr. SHERMAN. Thank you. I would like to recognize Mr. Lynch. I will ask him to try to limit himself to 3 minutes so that Mr. Tancredo can get in a question or two.

Mr. LYNCH. Okay. I will do my best. Mr. Chairman, to begin with, I have a list of companies investing in Iran's energy sector since 1996. So I would just ask to have this list entered.

Mr. SHERMAN. Without objection, so ordered.

Mr. LYNCH. Terrific. That gets that out of the way. I just want to go back. Mr. Scott raised a good issue. I am going to go from the specific to the general. Mr. Simons acknowledged that our ability to enforce these sanctions depends greatly on the cooperation of our international neighbors especially in the medium and the long-term.

The framework for doing that really is dependent on the anti-money laundering legislation adopted by these individual countries, and whether or not—as Mr. Glaser is responsible for or deals with—setting up certain FIUs. I have been traveling around the Middle East trying to get some countries who have not established FIUs to do so, namely Jordan and there are a whole host of others.

We need that transparency I think because if the Oil for Food program was any indication of our ability to have effective sanctions, then it is going to rely extremely highly on the cooperation of our international neighbors. Mr. Glaser, how are we doing? I know we had great cooperation initially. Everybody signed the convention on antiterrorism financing. We got some FIUs stood up. A lot were not stood up, and we are still in the process of doing that but you know I sense there is some falling off in terms of enforceability and things like that.

We have to have that framework in place if these sanctions are going to work, even if we get them passed through the U.N. Could you comment on that, sir?

Mr. GLASER. Yes. I would be happy to, Congressman, and I think the points you make are exactly right. A strong anti-money laundering regulatory regime and the transparency to that creates is fundamental to the effectiveness of implementing any type of sanctions program. Certainly any type of targeted financial sanctions program. So it is so important that countries throughout the world implement international standards in anti-money laundering, counterterrorist financing, and that really is a large part of my job is to work with the international community on those types of issues.

I think you have pointed out some of the countries that still need work. Jordan is certainly one of the countries that still needs to enact a comprehensive anti-money laundering law, and there are other countries as well. So we do have work ahead.

One thing I can say is that I think the whole context of the debate has shifted. When I first started working in this area 10 years ago, there was a legitimate question in the international community as to whether countries even had to do this at all. I think we

have moved past that. Over 175 countries have made political commitments to implement the FATF standards, the international standards on anti-money laundering.

So now the question goes to implementation, and frankly that is the harder issue. We work with FATF. We work with FATF-style regional bodies. We work in the G-7. We work bilaterally to try to emphasize the importance of this, and I agree with you. We need to keep the pressure up, and we need to keep our focus up. I am not sure that international compliance with these standards has dropped. I think in fact it is probably improving but maybe the publicity it receives has dropped a little bit, and maybe we have not been focusing as much as we can on certain jurisdictions but I do think it is a very important issue.

Mr. SHERMAN. Thank you, Mr. Glaser. Now let us recognize the gentleman from Colorado.

Mr. TANCREDO. Thank you, Mr. Chairman. Just quickly, I know we are running out of time. When we were talking about the importance of having multilateral sanctions and how unilateral sanctions essentially do not work unless you can get this kind of cooperation from the rest of the world, how do you do that if you are not willing to have unilateral sanctions yourself? I mean can the United States act in that capacity? Did we have to have 29 years of unilateral sanctions against Iran in order to get to the point of actually having the rest of the world community come along with us or do we not impose sanctions first while we are waiting to gather this international support?

Mr. GLASER. Well I mean I think it is certainly true that any financial measure, be it a sanction or otherwise, is more effective if it is applied in a multilateral context.

Mr. TANCREDO. Undeniably.

Mr. GLASER. Certainly as broad as possible. That said, I do think there are things that we can do and have done not in a multilateral context that can be very effective. As was pointed out, I think our use of Section 311 of the Patriot Act has been very effective. I think that our dialogue with the international financial community to try to educate them on the risks of doing business with jurisdictions like Iran has been very effective, and I think that some of the designations that Mr. Szubin implements with respect to banks like Bank Sepah have been very effective.

The key is then taking those actions and multilateralizing them to make them even more effective, and I think that we have been working really hard on that, and we are seeing the success. Part of the problem frankly is that you know we are very grateful to Congress for giving us the tools that we need to be very agile in our approach to these issues. Most of the countries we cooperate with.

Frankly most of the very sophisticated countries with cooperate do not have nearly the set of tools that we have at our disposal, and part of what we try to do as we engage with them is to say, look, we have these Executive Orders. We have Section 311. We have OFAC. You need to develop these things too to enhance our bilateral and multilateral cooperation.

Mr. TANCREDO. Okay. I understand that the flexibility given you in those situations can be helpful but I have to agree with the

chairman in terms of the fact that I think you have taken some actions that are beyond the provisions of the laws that were enacted by Congress, and specifically what he mentioned in terms of allowing financial support to flow. So again, I want to congratulate you on your successes.

I want to tell you, however, that I am certainly concerned about the fact that it seems like we have an inability here to actually define which part of those sanctions will actually hurt the people of the country, which part of the sanctions actually work to change regime. That is something we will have to continue at a later date but it is a very tough line to draw here.

Mr. SHERMAN. I want to thank the first panel. Mr. Simons, please respond to my question for the record at length, and there may be other questions for the record submitted by members. We will stand adjourned until 4:45 or until after the last vote which ever shall occur later. Thank you to the first panel. I look forward to the second panel.

[Whereupon, at 3:53 p.m., the subcommittee recessed, to reconvene at 4:45 p.m. the same day.]

Mr. SHERMAN. Folks, welcome back. I want to thank a very patient second panel for waiting for the last hour-and-a-half, and I want to introduce our first witness who I know had to delay her flight. She is not on the six p.m. flight back to Missouri. I want to welcome Sarah Steelman, Treasurer of the State of Missouri. She oversaw the first successful divestment of a U.S. State's employee pension fund from investing in companies that support regimes which sponsor terrorism.

She was formerly a member of the Missouri Senate, Deputy Director of the Missouri Department of Natural Resources, and an adjunct professor of economics at Lincoln University. I want to thank you for your trailblazing efforts. I look forward to some day seeing CalPERS and CalSTERS follow your lead and look forward to hearing your testimony.

**STATEMENT OF THE HONORABLE SARAH STEELMAN,  
TREASURER, STATE OF MISSOURI**

Ms. STEELMAN. Thank you, Mr. Chairman, and I look forward to that day too, and have very much appreciated your remarks here today. It has restored my faith in Congress as well. So I appreciate the opportunity to be here today, and I am really grateful to you all for examining this important issue, and very appreciative to be asked to provide a little perspective from the "Show-Me State" where what you do is more important than what you say, and I believe as you do that this is one of the truly critical issues facing our nation, and these are unparalleled times and your leadership on this issue is so important and it is so needed.

And I fear too often what is really at stake is forgotten in this national debate, and that this is really about our families, and it is about our husbands and our wives and our brothers and our sisters and our sons and daughters because it is about keeping them safe and secure, and in the effort to do so, it seems strange that we send young men and women to defend us, some of whom have paid the ultimate sacrifice.

However, we have not yet used one of our most powerful weapons, America's financial markets. We face serious threats around this world from terrorists and terrorist sponsoring nations, and it was shocking to us in Missouri to find out that we in America are funding the very enemies we are fighting through our investments. Billions and billions of dollars worth.

And I believe Missourians are in-line with the rest of this nation on the issue. A recent poll showed that more than 80 percent of those surveyed say that if they learn that a company in which they have invested was found to be doing business in a state sponsor of terrorism, like Iran or Sudan or North Korea or Syria, they would either sell that investment or they would demand the company cease doing business with the terrorist supporting nation.

The attack that took the lives of thousands on September 11 cost money. The roadside bombs that kill our soldiers in Iraq and Afghanistan cost money. The nuclear weapons Iran hopes to use on this country cost money. These threats we face can be defeated but it will take a resolute and comprehensive response.

Someone who knew quite a lot about big problems facing our nation had this to say back in 1862, "The dogmas of the quiet past are inadequate to the stormy present. The occasion is piled high with difficulty, and we must rise with the occasion. As our case is known, so we must think anew and act anew. We must disenthrall ourselves and then we shall save our country." In Missouri, we have heeded that wise admonition, and the people have responded by telling us that we are doing the right thing, and it is our belief the missing element in the debate thus far has been the use of the economic weapons at our disposal.

The war on terror should be fought on this new battlefield, and every American can play a major part by using America's financial weapons. The weapon is at every American's disposal. We can rise to the occasion together.

So by cutting off these billions of dollars going to known sponsors of terror we can make a decisive difference in this fight. In Missouri, we believe it is wrong to use public money, taxpayers' money, to fund our enemies and to subject shareholders to the inherent risk associated with these investments, and so some of the actions that we have taken in Missouri include the following.

We have implemented tough antiterror policies in the Treasurer's Office including complete prohibitions on doing business with terrorist sponsoring nations and companies, and this approach is working. UBS, Credit Suisse and other companies have stopped doing business in Iran, at least in part because of this kind of pressure.

We implemented the nation's first terror-free public fund which screens out terror tied stocks from the portfolio. It is managed by State Street Global Advisors, the world's largest institutional investment company, and since inception our terror-free fund has significantly outperformed the international fund benchmark which contains the terror tied stocks. Again, one reason for this I believe is that there is a significant risk to share value associated with these stocks, a risk that investors should know about and be protected from. And to date we are looking at a rate of return of 19.15 percent versus the benchmark which is at 15.25 percent.

We have set up the nation's first terrorism screening policy and divestment procedure for a public pension fund, and our public pension fund contains about \$6 billion in investments total, of which \$20 million we initially identified as being invested in stocks that are tied to terrorism. And let me remind the committee—and I know you all know this—economic sanctions imposed on these state sponsors of terrorism like Iran, Syria, North Korea and Sudan, means that an American cannot do business in those countries, yet billions of taxpayer dollars are invested in those companies which is absolutely wrong first of all because it is funding our enemies, and secondly by investing in those companies we are undercutting the economic effect of those sanctions.

Thirdly, those investments in multinational companies are at the expense of the American worker, and lastly we owe it to the taxpayers and pensioners to protect their pensions from shareholder risks involved in investing in these countries. We are also in Missouri in the process of offering the first terror-free mutual fund in our 529 plan as well as an international terror-free fund for our 529 college savings plan so that every Missourian has the choice to save tax free—it is tax free—and terror free.

We have written and encouraged all other State treasurers across the country to take similar actions. We hosted a police and firefighter terror-free investment summit to educate our law enforcement personnel about how their pension funds may be funding the very enemies that they may have to face, and we are currently in Missouri pressing hard on our legislature to pass a resolution calling on all of our State pension funds to divest from terror and go terror free.

And you may hear from the so-called experts staff from your pension systems or others like we did various arguments made against the policies, and there is room for debate on some issues but our experience in Missouri has shown that the arguments we heard and that you may hear in the coming weeks were either undocumented, illogical, inconsistent or simply untrue, and I think I have provided some of those arguments in the written testimony that I have provided to the committee.

But whatever arguments you may have hear, there can be no argument against this: That we are engaged in a monumental struggle with the most serious consequences. As Lincoln said, it is truly a question of saving our country. Every effort and every means to win this fight and every person in this country should be a part of the victory, and let me just say again and I am speaking on behalf of the heartland of America, and we decided in Missouri that we cannot wait for somebody else to do this.

And with all due respect to Congress, and the President, and the administration, in Missouri we decided to act, and frankly that is what is missing in the war on terror which is giving every American a way to help engage and protect their families and their nation. So I would ask that we try to cut off the billions of dollars going to these regimes and that we can make a critical difference in this fight.

But to get there, Congress must act, State legislators must act, pension systems must act, private investors must act, and Wall Street must act, and I will say it once again. What we need most

of all, what will ensure a victory just as it always has is that the people of this country must act, and when we do, we will find ourselves in a much better, much safer world for our children and our children's children. Thank you, Mr. Chairman.

[The prepared statement of Ms. Steelman follows:]

PREPARED STATEMENT OF THE HONORABLE SARAH STEELMAN, TREASURER, STATE OF MISSOURI

Thank you Chairmen Lantos, Frank, Sherman and Gutierrez and members of the committee. I am so grateful to you for examining this important issue and am very appreciative to be asked to provide a little perspective from the Show-Me State. I believe, as you do, that this is one of the truly critical issues facing our nation. These are unparalleled times, and your leadership on this issue is so important and so very needed.

I fear that too often what is really at stake is forgotten in our national debate. This is really about our families. It is about our husbands and wives, brothers and sisters, sons and daughters. It is about keeping them safe and secure. And in the effort to do so, it seems strange that we send young men and woman to defend us, some of whom pay the ultimate sacrifice—however we have not yet used one of our most powerful weapons—America's financial markets.

We face serious threats around this world from terrorists and terror-sponsoring nations. It was shocking to us in Missouri to find out that we in America are funding the very enemies we're fighting through our investments—billions and billions of dollars worth. And I believe Missourians are in line with the rest of this nation on this issue. A recent poll conducted for the Center for Security Policy showed that more than 80% of those surveyed say that if they learned that a company in which they have invested was found to be doing business in a state sponsor of terrorism, like Iran, Syria or Sudan, they would either sell that investment or demand the company cease doing business with the terror supporting nation.

The attacks that took the lives of thousands on 9/11 cost money. The roadside bombs that kill our soldiers in Iraq and Afghanistan cost money. The nuclear weapons Iran hopes to use on this country cost money. These threats we face can be defeated, but it will take a resolute and comprehensive response. Someone who knew quite a lot about big problems facing our nation had this to say back in 1862: "The dogmas of the quiet past, are inadequate to the stormy present. The occasion is piled high with difficulty, and we must rise—with the occasion. As our case is new, so we must think anew, and act anew. We must disenthrall ourselves, and then we shall save our country." In Missouri, we've heeded that wise admonition and the people have responded by telling us that we are doing the right thing. It is our belief the missing element in the debate thus far has been the use of the economic weapons at our disposal. The war on terror should be fought on this new battlefield—and every American can play a major part—by using America's financial weapons, the weapons at every American's disposal, we can rise to this occasion, together.

By cutting off these billions of dollars going to known sponsors of terror, we can make a decisive difference in this fight. In Missouri we believe it is wrong to use public money—taxpayers' money—to fund our enemies and to subject shareholders to the inherent risk associated with these investments. Some of the actions we've taken include the following:

- We've implemented tough anti-terror policies in the Treasurer's office including complete prohibitions on doing business with terror sponsoring nations and companies. And this approach is working—UBS, Credit Suisse and other companies have stopped doing business in Iran at least in part because of this kind of pressure.
- We've implemented the nation's first terror-free public fund, which screens out terror-tied stocks from the portfolio, managed by State Street Global Advisors, the world's largest institutional investment company. Since inception, our terror free fund has significantly outperformed the international fund benchmark which contains the terror-tied stocks—again, one reason for this, I believe, is that there is a significant risk to share value associated with these stocks, a risk that investors should know about and be protected from.
- We've set up the nation's first terrorism screening policy and divestment procedure for a public pension fund.
- We are in the process of offering the first terror-free mutual fund in a state college savings plan

- We have written and encouraged all the other state treasurers across the country to take similar actions
- We hosted a police and firefighter terror-free investment summit and are now working hand in hand with several of those systems to make them terror-free
- We are currently pressing hard on our legislature to pass a resolution calling on all our state pension systems to go terror-free

You may hear from so-called experts, staff from your pension systems or others, like we did, various arguments made against these policies. While there is room for debate on some issues, our experience in Missouri has shown that that the arguments we heard and that you may hear in the coming weeks were either undocumented, illogical, inconsistent or simply untrue. Let me share with you some of these arguments and our experience in Missouri:

1. “Won’t the costs be too high?”—Asset managers typically sell stocks on a daily basis, so the costs should be no different than sales of a stock incurred through the normal buying and selling of stocks within a portfolio. Moreover, most asset managers are compensated on a percentage computed of assets under management, not their or the custodial banks’ actual transaction costs.

In the case of the Missouri Investment Trust’s international fund, the fees quoted by State Street for the screening and management of this fund were within a typical management fee for an actively managed product. Indeed, fees quoted by all of the firms responded to our bid were within normal ranges. And again, the performance of the fund has dramatically outpaced its benchmark.

2. “Will Wall Street respond?”—Our experience in seeking managers for our MIT Fund proved otherwise. We received proposals from several Wall Street firms. Additionally, we have seen a number of global asset managers respond with products for states that have adopted laws or policies requiring divestment from Sudan. If institutional accounts demand a new product, history has shown that managers will respond. And we have heard this directly from many asset managers.
3. “Is divestment effective?”—Putting aside the overwhelmingly successful divestment example of South Africa, we have already seen early in this effort a number of companies—foreign as well as domestic—respond to the pressure of institutional shareholders when it comes to the issue of terrorism. For example, last year two global banking giants—UBS and Credit Suisse—announced they were pulling out of Iran. UBS now operates a global security risk management program that speaks to this very issue.
4. “This is too hard or complicated to do?”—We have found that, using the services of quality companies and based on a sound policy that clearly defines the nature of business relationships in question, it is relatively straightforward to identify major foreign companies operating in these nations. Even before securing the services of outside help, we were struck by how boldly most European and Asian companies operating in these countries announced their presence in Iran to their stockholders and public via press releases on their website, disclosures in their financial statements or other media.
5. “Will the divestment effort damage returns?”—Once again, our experience at the Missouri Investment Trust proves otherwise. Since inception of our terror-free international fund through the end of February of this year, our fund has outperformed the MSCI EAFE index (the benchmark for core international strategies) by a nonannualized rate of 3.90%.

Additionally, the returns of Missouri’s state employee retirement system, MOSERS, continue to be in the upper quartile of its peers after implementation of a new anti-terrorism policy in 2005.

Whatever arguments you may hear, there can be no argument against this: we are engaged in a monumental struggle with the most serious of consequences—as Lincoln said it is truly a question of saving our country. Every effort and means to win this fight, and every person in this country, should be a part of the victory.

By cutting off billions of dollars of lifeblood to these regimes, we can make a critical difference in this fight. To get there Congress must act, state legislators must act, pensions systems must act, private investors must act and Wall Street must act. But what we need most of all, what will ensure a victory, just as it always has—is that the people of this great country must act. And when we do that, we will find ourselves in a much better, much safer world for our children and our children’s children.

Thank you again for this wonderful opportunity to visit with you.

Mr. SHERMAN. Thank you, Madam Treasurer. Next, Roger Robinson is the President and Chief Executive Officer of Conflict Securities Advisory Group, a private company that has been instrumental in helping investors determine which companies are actively engaged in business with particular regimes. He was formerly Senior Director of International Economic Affairs at the National Security Council and Executive Secretary of the Cabinet Level Senior Intergovernmental Group for International Economic Policy. Roger.

**STATEMENT OF MR. ROGER W. ROBINSON, JR., PRESIDENT  
AND CHIEF EXECUTIVE OFFICER, CONFLICT SECURITIES  
ADVISORY GROUP**

Mr. ROBINSON. Thank you, Mr. Chairman. Indeed it is a privilege to appear before you and committee members today. I thank you for that. My company, Conflict Securities Advisory Group, is an independent impartial research provider, as you pointed out, specializing in the field of what has become known as global security risk management and the implementation of terror-free investing strategies. Just a word on global security risk, because it is central I think to this particular dimension of your inquiry.

It is defined by the SEC and others as the risk to share value and corporate reputation stemming from company ties to U.S. sanctioned states, principle among them the terrorist sponsoring nations. Our company, CSAG as we call it, was established in the fall of 2001, and maintained the world's most comprehensive database on every publicly traded company globally with business ties to Iran, Sudan, Syria and North Korea as well as public firms that have been associated with weapons of mass destruction and ballistic missile proliferation.

In this connection, our global security risk monitor online service identifies some 450 mostly foreign companies with business ties to these countries, some 340 of which have ties to Iran alone. We provide our data to scores of asset managers, pension funds, State and Federal entities including the Security and Exchange Commission's Office of Global Security Risk, and have had the good fortune to coordinate closely with private sector as well as public fund managers, including the great State of Missouri on structuring and implementing terror-free investing portfolios.

I would like to say that as such, as an independent research provider, we are not commenting on or we do not take a position on legislation or U.S. policy initiatives but to the extent that I do so today it would be my personal views and not necessarily those of the company.

Now, trying to get quickly to some of the issues you care about most, not surprisingly about 60 percent of the companies in our database are engaged in some dimensions of the energy sector, particularly with respect to the oil producing states like Iran, Sudan and Syria. It is no exaggeration to say something you have no doubt learned in today's hearing from a number of sources, that were these public companies to withdraw from terrorist sponsoring states, export earnings for the most part would plummet and economic and financial crises would likely ensue.

Indeed it is fair to say that publicly traded companies provide, wittingly or unwittingly, vital life support to these regimes in a number of sectors beyond energy including telecommunications, electric power generation, and manufacturing. Now there was some talk about the official sanctions and how they have performed. Mr. Chairman, in my view you have correctly characterized the ineffectual implementation of the Iran-Libya Sanctions Act and its successor legislation, the Iran Sanctions Act.

In the course of my submitted testimony, I discuss other elements of global security risk, the mechanics of terror-free investing, examples of municipals, State and private sector shareholder activism, and the implementation, cost and performance with respect to terror-free investing. So I will put that aside for the written testimony, and just give you a sense of where we are from the point of view of terror-free investing today.

It is a fact that the American people overwhelmingly care about where their retirement dollars are going and how they are being used. There was a recent poll by Leslie Lenkowsky firm that put in striking detail the fact that some 80 percent of the American people that were polled were prepared to take lower returns on investments in order to avoid companies partnering with terrorist sponsoring regimes, and the other numbers are equally dramatic if not more so.

There is no question, therefore, that given a choice American investors would prefer to avoid doing business with companies that have those types of material business arrangements with these regimes. It has been a matter of opportunity to make that choice, and I think that where Treasurer Steelman is owed a great debt of gratitude is the fact that she was the first to step forward with a public fund and take it terror-free, and in so doing particularly with her State's 529 college savings plan, open up this chance for every American.

The first mutual fund has now gone terror-free some 2 years ago the Roosevelt Anti-Terror Multi-Cap Fund, that again makes this opportunity available, and certain States in the way that they are pursuing legislative remedies have likewise started to open up a market to convince Wall Street to provide something that heretofore has been utterly neglected, which is terror-free or Iran-free products and services.

This is a matter of not only the American people learning about where their money is really going and how it is being used but also the opportunity to move that money out of those companies if they should choose to do so into a place where they can readily continue their investing patterns without necessarily taking even a loss. In fact, not only do you not have to sacrifice returns, but in the case of Missouri and other precedents, those returns have actually been better.

I would just take you to the fact that several States, as you know, have introduced legislation. There are different types, and this is an important distinction because for example some States are just concentrating on companies that are in the Iranian energy sector and are indeed even violators of the Iran Sanctions Act at the \$20 million or more level. How many companies do you suspect are involved? Maybe 20? How many of those are state owned with

very little of their shares traded in the open markets? And the bigger question is: What about the other 320 companies that are providing vital life support to the regime in Tehran?

So you have very limited what is called now targeted divestment but the question with targeted divestment—

Mr. SHERMAN. Mr. Robinson, can you just sum up in a couple of sentences?

Mr. ROBINSON. Yes. Is how much is it really doing versus the blanket variety which tends to put an electrified fence around companies that wish to do business with those countries. So I am happy to talk a bit more to that in the questions and answers but thank you for your time.

[The prepared statement of Mr. Robinson follows:]

PREPARED STATEMENT OF MR. ROGER W. ROBINSON, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, CONFLICT SECURITIES ADVISORY GROUP

Mr. Chairman and Committee members, it is a privilege to have this opportunity to testify before this joint hearing entitled “Punishing the Proliferators and Sponsors of Terror: Using Financial and Economic Sanctions to Change Regime Behavior.” I am President & CEO of Conflict Securities Advisory Group, Inc. (CSAG), an independent, impartial research provider specializing in the field of global security risk management and the implementation of terror-free investing strategies. In the way of background, I am an international banker by training, having served as a Vice President in the International Department of the Chase Manhattan Bank with responsibility for Chase’s loan portfolios in the former Soviet Union, Eastern and Central Europe and Yugoslavia. I also served as a personal assistant to former Chase Chairman David Rockefeller. In government, I held the post of Senior Director of International Economic Affairs at the National Security Council from March 1982 to September 1985 and later served as Chairman of the Congressional U.S.-China Economic and Security Review Commission until January 2006.

Established in the fall of 2001, CSAG maintains the world’s most comprehensive database on every publicly traded company globally with business ties to Iran, Sudan, Syria and North Korea as well as public firms that have been associated with WMD and ballistic missile proliferation. These countries have each been designated by the U.S. Department of State as official sponsors of terrorism. In this connection, our *Global Security Risk Monitor* online service identifies some 450 mostly foreign companies with business ties to these countries, roughly 340 of which have ties to Iran.

CSAG provides data to scores of asset managers, pension systems and state and federal entities, including the Securities and Exchange Commission’s Office of Global Security Risk.<sup>1</sup> CSAG has also coordinated extensively with those officials overseeing public funds, including from the state of Missouri, as well as private fund managers in structuring and implementing “terror-free” investment portfolios.

At the outset, I would like to make clear that CSAG, as an impartial research firm, takes no position on legislation or U.S. policy initiatives, nor does it take a position on the use of our data by clients. That said, we are prepared to share our professional views on the feasibility of “terror-free” or “Iran-free” investment policies and screens and other technical issues of potential interest to the Committee. In making observations on the Iranian economy and non-technical issues, the views expressed herein are my own and do not necessarily reflect the views of Conflict Securities Advisory Group, Inc.

*Corporate Activity in State Sponsors of Terrorism*

Not surprisingly, the majority of companies with ties to terrorist-sponsoring states—some 60%—are engaged in various dimensions of the energy sector, particularly with respect to the oil-producing states (i.e., Iran, Sudan and Syria). In addition to large energy firms involved in major oil and gas projects like Total, ENI, Sinopec, Gazprom and Shell, there are also a number of companies engaged in downstream operations.

<sup>1</sup> Global security risk is defined by the SEC and others as the risk to share value and corporate reputation of companies with business ties to U.S.-sanctioned countries, including the terrorist-sponsoring nations.

It is no exaggeration to assert that were these public companies to curtail their activities in such countries, particularly in Iran and Sudan, energy-related exports would plummet and economic/financial crises would likely ensue. Indeed, it is fair to say that publicly traded companies provide, wittingly or unwittingly, vital life-support to these regimes in a number of sectors beyond energy, including telecommunications, electric power generation and manufacturing. In some cases, this support takes the form of sales of advanced equipment and technology (some of it “dual use”) as well as the supply of know-how and often large-scale revenue streams.

As your Committees are aware, U.S. sanctions under the Iran Sanctions Act, and its predecessor legislation, the Iran-Libya Sanctions Act, have been consistently waived by the Executive Branch and have therefore only been of nuisance value. The Bush Administration’s financial sanctions against Iran and North Korea, however, have had a chilling effect on the willingness of international financial institutions to continue doing business with these states, including certain of Iran’s major banks (notably Bank Saderat and Bank Sepah). The cut-back in the availability of official credit guarantee and insurance programs by certain U.S. allies, like Japan, has also had a material, negative impact on the ability of Iran to attract needed financing for larger-scale projects and transactions.

These official sanctions have been accompanied by what is becoming an even more important inhibitor to the ability of terrorist-sponsoring states to fund themselves and their malevolent activities, specifically security-minded shareholder activism and global security risk management in the private sector.

#### *Enter Global Security Risk*

In May 2001, the Securities and Exchange Commission (SEC) determined that publicly traded companies that do business in U.S.-sanctioned countries, such as Iran, are exposed to “global security risk,” even if such activities are legal and commercial in nature. Such risks can be material and impact adversely on share value and corporate reputation. Among the risks to which companies doing business in terrorist-sponsoring states are exposed include: new U.S., U.N., or other official sanctions that affect a company’s operations; sanctions violations; negative publicity; law suits by victim’s rights and other groups; and opposition-oriented shareholder activism, including divestment campaigns. This financial risk can be compounded by firms doing business in more than one terrorist-sponsoring state and/or in sectors of these economies that have a record of the diversion of commercial equipment, technology and revenues to military-related purposes.

As a result of this heightened financial risk profile, a number of fiduciaries that have contacted CSAG have indicated a desire to exercise greater caution with respect to investing in companies with operations in the terrorist-sponsoring states. This established financial risk is also what differentiates “global security risk” from other categories of values-based or socially responsible investing (e.g., environment, tobacco, Burma, guns, alcohol, etc.). In short, even if a fiduciary does not share the moral, ethical or security-related concerns of other investors, in the protection of portfolio value, it is only prudent to account for this risk category.

#### *Terror-Free Investing*

Terror-free investing is defined as excluding from portfolio some or all of the approximately 450 publicly traded companies with business ties to, or operations in, State Department-designated terrorist-sponsoring states, specifically Iran, Sudan, Syria and North Korea. Typically, the fiduciary determines the threshold or “bright-line” for what scope or type of corporate activity in these countries would merit exclusion from investment portfolios and be determined non-compliant under a new investment policy adopted by the fiduciary.

For actively managed stocks, maintaining “terror-free” compliance is quite straightforward and inexpensive. With the specific threshold in hand, CSAG can determine which companies in our database would be non-compliant and off-limits to the fund manager or fiduciary. Once that list of non-compliant companies is developed, the manager sells the shares of current holdings that are non-compliant (perhaps over a period of time). Thereafter, the manager maintains the screen (or a “do not buy” list) provided by an independent research firm, like CSAG, and certifies to their client that they are in compliance with the new investment policy on a quarterly basis.

The greater challenge lies in passive investments, such as an index. If index providers offered “terror-free” indexes, as will soon occur, fiduciaries or their asset managers could invest in such certified products in order to comply with a given terror-free or Iran-free investment policy. Regrettably, this is the “chicken and egg” issue facing several states that wish to exclude companies with business ties to one

or more of these countries. The simple fact is that indexes are pools of stocks available to many clients. Fiduciaries cannot merely ask that non-compliant companies be removed. Rather, entirely new “terror-free” indexes need to be built. In that sense, state legislative initiatives can “drive the market.”

In the case of Illinois’ legislated divestment of companies with Sudan ties, the state’s asset managers took the step of requesting prominent index managers (notably from Northern Trust and Barclay’s Global) to create new “Sudan-free” funds to which index-invested assets of the State’s pension funds could be moved. The business logic for these firms was compelling because demand for such new investment products was established by the legislation. Such “Sudan-free” products could also serve as a differentiator for these firms in the markets. As it turned out, this approach proved successful and the first index-managed fund providers attracted billions of dollars to their new “Sudan-free” products in a relatively short period of time.

In sum, by defining a list of companies in which asset managers cannot invest and then requiring them to certify that they are compliant with this list, the likely effect would be to create a compelling financial incentive for financial firms to produce indexes and similar pooled investment vehicles. The Illinois example makes clear that asset managers will respond to these kinds of legislative initiatives. It is also our understanding that the entire divestment process in Illinois with respect to Sudan required no new layers of bureaucracy or cost to the state. The modest costs involved were borne by the state’s external fund managers. The important corollary benefit of the creation of these new investment vehicles was their availability to individual investors throughout this country. Due to the market influence of Illinois’ public assets, individual Americans were presented with passive investment options that otherwise would have been unavailable had the state not taken these actions.

#### *Municipal, State and Private Sector Shareholder Activism*

New York City public pension systems were the first in the nation to react to global security risk, specifically the city’s firefighter and police pension systems. New York City Comptroller Thompson, with the database provided by our firm, has made global security risk concerns a top corporate governance priority for the past several years. Under Comptroller Thompson’s leadership, several U.S. firms doing business with terrorist-sponsoring states through their overseas subsidiaries were persuaded, via the City’s registering of shareholder resolutions, to exit these countries once existing contracts were concluded (e.g., Halliburton, ConocoPhillips, GE, Cooper Cameron and Aon Corporation). New York City has likewise been in communication with scores of other portfolio companies requesting explanations for their business activities in these countries.

After the airing of a “60 Minutes” segment entitled “Doing Business with the Enemy” twice in 2004, a number of states, as well as average investors became alert to this risk category and began to take action. Today, some eight states have introduced divestment legislation with respect to companies doing business in one or more of these countries, including California, Florida, Georgia, Maryland, New Jersey, Texas, Ohio and Pennsylvania. Ohio’s Iran divestment legislation is of particular interest as it is the most hotly contested between those seeking to defeat this legislation, including Ohio’s public pension systems, and those that believe this is an appropriate response to elevated financial risk and the values of Ohio’s public employees. Several other states have already passed legislation divesting from some, if not all, companies with business operations in genocide-sponsoring Sudan. The first public fund to go “terror-free” was the Missouri Investment Trust under the leadership of State Treasurer Sarah Steelman who is with us today. That fund, administered by State Street Global Advisors, was screened and certified by CSAG.

In the private sector, Nationwide Financial has made a terror-free mutual fund available on its 401(k) platforms to some 50,000 corporate and public entity clients. The Roosevelt Investment Group in New York was the first fund manager in America to introduce a terror-free mutual fund (certified by CSAG)—the Roosevelt Anti-Terror Multi-Cap Fund ([www.anti-terrorfund.com](http://www.anti-terrorfund.com)). There are also a number of “terror-free” products and services expected to come to market in the next several months, including a family of mutual funds, index-managed funds, Exchange Traded Funds and separately managed accounts.

These public and private sector developments, including two ongoing Federal legislative initiatives with respect to Iran divestment, all point to the fact that institutional and individual investors now have a choice with respect to whether or not to screen out some or all portfolio companies with ties to terrorist-sponsoring regimes.

### *Implementation, Costs and Performance*

The primary argument against divestment and terror-free investing screens is the prospect of reduced investment returns. Given the exposure of these companies to global security risk, however, there is a valid argument to be made that continuing to hold certain of these companies in portfolio could actually harm performance. In fact, those investors that have now successfully structured “terror-free” portfolios have outperformed their benchmarks. Moreover, the “Sudan-free” index-managed funds referenced earlier have reportedly performed quite well for Illinois.

With respect to costs, it would likely be helpful to evaluate the experiences of other states. For example, Illinois’ succeeded in having some 15 statewide pension systems and scores of asset managers divest from roughly 150 companies with ties to Sudan with minimal disruption or impact on state investments and at no apparent cost to the state of Illinois. This is largely because Illinois placed the implementation requirement on the state’s external asset managers and, by statute, required that they absorb the modest costs involved.

In the case of index products, the movement of assets to new funds that are certified to meet various legislated investment policies would be required. Nevertheless, it is not necessarily the case that such adjustments would require significant costs or losses for the state. Indeed, there are precedents indicating that this is not the case. The reality is that if a state pension system were to request a “terror-free” index, given its market leverage, investment managers would almost surely respond. Furthermore, we would be perplexed by arguments suggesting that their fees would increase significantly if they did so. If a manager is going to gain a mandate to manage a sizable portfolio, why would such a firm *upcharge* for the “terror-free” component?

Returning to performance, the Missouri Investment Trust, as mentioned, recently worked with our firm to become the first public fund in the country to invest “terror-free.” Although CSAG is not an investment advisor or manager, we understand that the results have been impressive. To briefly review how this came to pass, MIT worked with CSAG in the manner described above to use its “terror-free” policy to establish a “do not buy” list that was then sent to its manager, State Street Global Advisors. State Street then removed non-compliant companies from its index benchmark, rebalanced the portfolio and, on a quarterly basis thereafter, ensured that the portfolio excluded companies on the “do not buy” list.

As Treasurer Sarah Steelman will likely testify, the seven-month returns have recently been made public. Over this period, the “terror-free” portfolio has outperformed its benchmark by a significant margin. This experience may not be representative of the results of terror-free investing for other funds, but it certainly is evidence that: 1) terror-free investing is possible at a modest cost; and 2) it may not have the type of negative performance forecasted by detractors.

### *Conclusion*

There are now a number of concrete indicators that, over time, global security risk (which underpins “terror-free” investing) will likely become a standard, “boiler-plate” component of most larger-scale investment policies, corporate governance deliberations and due diligence risk assessments here and abroad. There was also a recent national poll conducted by the firm Luntz, Maslansky Strategic Research that indicated that a large majority of American investors care about this issue and are prepared to react to these corporate involvements in their individual investment decisions and those made on their behalf by institutional investors.

Accordingly, the process of excluding certain categories of companies due to the nature and scope of their business operations in terrorist-sponsoring states like Iran appears to be rapidly gaining traction. As the precedents for successful terror-free investing multiply and more index-managed funds and similar “passive” investment products are made available, the task of going terror-free or Iran-free, which is already rather straightforward and inexpensive, will get easier still.

Although public pension systems are legitimately concerned about the “slippery slope” of social issues increasingly restricting their investible universe, the financial risk elements associated with the activities of public companies in Iran and other terrorist-sponsoring states can be legitimately taken into account by state legislators and public and private sector fund managers in a manner consistent with their oversight and fiduciary responsibilities.

The bottom line is that “terror-free” investing is now a matter of choice, without the past implementation burden. To the extent that average Americans wish to react to these risk elements or screen against such corporate ties as an expression of their values, terror-free investing is an option that is likely here to stay.

Mr. SHERMAN. Thank you. Now the first panel of course was entirely from the Bush administration. This panel is entirely not part of the administration. I got to pick four of you. I am going to call upon the witness chosen by Mr. Royce, but before I do, I have to comment on Mr. Royce's incredible ecumenical spirit. Mr. Blum, I thought you were chosen by Mr. Royce. You said you were the minority witness. Ron Paul chose. So we have two minority witnesses.

I will cleanse Mr. Royce of association with you, and indicate it is Mr. Paul who selected you, and point out that it is Mr. Paul who is remarkably ecumenical in that he has chosen not only a very qualified witness, but one who is general counsel of Americans for Democratic Action. During your 14-year tenure as counsel to various Senate committees, Mr. Blum, you have played a key role in conducting several high profile investigations including the BCCI scandal, General Noriega's drug trafficking and foreign bribery by the Lockheed Corporation. Mr. Blum is also former chair of the United Nations Experts Group on Asset Recovery. Let us hear from the witness selected by Mr. Paul.

**STATEMENT OF MR. JACK BLUM, COUNSEL, BAKER HOSTETLER (FORMER SPECIAL COUNSEL FOR SENATE FOREIGN RELATIONS SUBCOMMITTEE ON TERRORISM, NARCOTICS, AND INTERNATIONAL OPERATIONS)**

Mr. BLUM. Thank you, Mr. Chairman. I am a skeptic when it comes to sanctions and how they work, and my skepticism is drawn from a long history of sanction failure which I outline in a prepared statement which I hope you will make a part of the record. But let me give you the personal anecdote that really brought it home. I was working with Senator Kerry in hearings by the Senate Foreign Relations Committee on drug trafficking by General Noriega.

The administration, becoming aware of the Noriega connections with arms trafficking and drug smuggling, imposed severe sanctions on Panama. A year after they were imposed, we asked the GAO to take a look at how effective they were. The report back was absolutely shocking. They were having virtually no impact. The use of offshore corporations, free trade zones and a variety of other tools enabled the Panamanians to get around the sanctions with impunity.

We learned in the course of it, by the way, that most of the seafood in Miami at the time was coming from Cuba, and it was coming through the free trade zones in Panama so that we had Panamanian sanctions and we had Cuban sanctions, and neither of them were working. Now in part this is because sanctions are enforced by the Office of Foreign Asset Control, approximately 125 employees, probably half of them work on chasing people who want to go to Cuba on vacation, and the other half in charge of all the sanctions everywhere else in the world, and they cannot possibly do that job.

You have heard the arguments about other failures of sanctions and why. I will not go into that territory. I believe you have seen Iran build nuclear weapons despite sanctions or head toward building it. You have seen Korea build a bomb successfully despite sanctions while the Korean population was busy eating grass, and

where if the sanctions had been fully applied we would have had a million North Koreans heading across the Yalu River into China.

I submit that is not the solution. The solution is much more targeted, focused efforts on the ways and means that nations use to get around the regimes that have been set up to control missile systems and the movement of nuclear material, and those regimes include prohibitions on shipping certain categories of goods, shipping certain sorts of nuclear materials. Now the big holes in the system at the moment are free trade zones and the fact that the biggest tool of international trade which is to say commercial letters of credit are really outside the current network of reporting of suspicious activity.

Most of the banks consider commercial letters of credit to be low risk business, and they simply do not provide the information or report in suspicious activity reports customers who are dealing with offshore entities and free trade zones where suspicious activity occurs. I submit that if you really want to do something effective and stay focused on weapons systems, delivery of weapons of mass destruction, there are ways to do it.

I was utterly amazed to discover the lack of coordination in the intelligence community on this subject. The intelligence community is getting a river of information but the people who are working on weapons in mass destruction are not plugged into the people who are getting the financial information in a proper way. The people who know what you should be looking for can use 314 of the Patriot Act to tell the financial institutions what to look for and what to report about, but they are not doing it.

There is very little communication about that with the financial institutions, and I would argue, that that, coupled with much more forthcoming cooperation and discussion with FATF and the European Union, would make an enormous difference in our ability to control proliferation. Instead we talk about things which perhaps make us feel a lot better but are not necessarily controlling that which we want to stop.

I think that a lot of what people have said about not wanting to invest and not wanting to do business with terrorist states is absolutely correct, and indeed I share that sentiment. I do not argue with people who say I do not want my money invested in a public company that does business in Iran. I would not invest in a public company that wants to support a regime I do not like. On the other hand, what happens in the real world is another matter, and what has been happening in the real world I am afraid is that we tend to bend.

So I will just leave you with this thought. The only major bank in the United States that maintains an account for an Iranian bank is the Federal Reserve Bank, and I note with some amusement that in all the discussion of the sanctions nobody has called the Fed in to say, what are you guys doing with that account?

[The prepared statement of Mr. Blum follows:]

**Statement of Jack A. Blum, Esq.**

**Before the House of Representatives**

**Committee on Foreign Affairs, Subcommittee on Terrorism,  
Nonproliferation, and Trade**

**And**

**The House Financial Services Committee, Subcommittee on Domestic and  
International Monetary Policy, Trade and Technology**

**Regarding**

**Isolating the Proliferators and Sponsors of Terror: The Use of Sanctions and  
the International Financial System to Change Regime Behavior**

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Dated: April 18, 2007

My name is Jack A. Blum. I am an attorney in private practice in Washington, D.C. I have worked on international financial issues for most of my career, fourteen years of which was spent on various Senate Committee staffs. I have extensive experience working with private clients and government agencies on issues of money laundering, Patriot Act compliance, foreign asset control issues, and the use of offshore financial havens to evade taxes and hide the proceeds of crime.

Broad embargoes and economic sanctions are not effective against rogue regimes. They will not deter the spread of weapons of mass destruction. They will not change regime behavior. If Congress wants to control the spread of weapons of mass destruction, and modify the behavior of rogue regimes, there are far better and more sophisticated tools available. Before turning to what might work, I will explain why I think embargoes and sanctions do not work.

The growing integration of the world economy allows too many ways to get around an embargo to make it effective in achieving the desired result. In the context of limited enforcement resources to enforce embargoes, an embargo becomes an exercise in punishing the compliant while the brazenly guilty go about their business. If an embargo is effective, the wrong people are usually the victims. In embargoed Iraq, infant mortality rose at the same rate Saddam built new palaces. North Korea built a nuclear bomb and its leader lived well while average people ate grass to prevent starvation.

Quite sensibly the Chinese government limited the impact of the Korean embargo because it feared a flood of refugees coming across the Yalu River. They did not want to take up that humanitarian burden.

The United States has been down the embargo and sanction road many times in the course of its history. The history is as instructive as it is bleak. The first American embargo was of Haiti in 1802. The Southern states were terrified by the slave revolt in Haiti and wanted it crushed. The resulting U.S. embargo succeeded in creating significant economic hardship, but fortunately, did nothing to achieve the intended result – the restoration of slavery on the Island. It can be argued that this early attempt to isolate Haiti was the beginning of that country's road to political ruin.

Some of our other notable embargoes that did not work include the embargo of the shipment of crude oil and petroleum products to Japan in the late 1930's. The embargo posed a dire threat to the Japanese economy which was already suffering as a result of the depression. The Japanese government and its ultra-nationalist military used the embargo as an excuse for invading what is now Indonesia and the Malay peninsula to get control of their oil production. Ultimately, it became the excuse for Pearl Harbor and the excuse of the Japanese leadership used when they were put on trial for war crimes. The embargo did not change the Japanese regime or its policies – it made matters worse.

Some of the more recent efforts at embargoes have been equally counterproductive. Marc Rich assembled one of the world's great fortunes by running the global embargo of petroleum and petroleum products to South Africa and the former Northern Rhodesia. As the world learned after the South African state democratized, shell companies in Caribbean were used to cover the

shipments and bank accounts in secrecy havens were used to cover the money flows and Rich's profits. The oil embargo led the apartheid government into the nuclear business and sent it down the road to proliferation.

The campaigns aimed at disinvestment and broader embargoes on South African goods had the effect of punishing the most liberal, and globally integrated, elements of the South African economy -- the manufacturers and exporters. They were marginalized and ignored by the Nationalists. They were also the ones who were pressuring the government for an end to apartheid even before the embargo was imposed.

There is, of course, the stunning example of the failure of the Cuban embargo. For political reasons, that embargo is the best enforced, and the law and regulations have the most draconian provisions. Cuban embargo enforcement absorbs most of the resources of the Treasury Department's Office of Foreign Asset Control.

As far as I can tell, it has had no noticeable impact on Cuba's political system. Indeed, I submit that the embargo has provided the Cuban Government with an excuse for its total failure at managing the country's economy and has been a political rallying point for the Castro regime. It has also cemented the relationship between Cuba and Hugo Chavez in Venezuela.

The global arms embargo imposed on the former Yugoslavia during the Balkan war was ignored by major arms suppliers who ran Russian military equipment through free trade zones in the Arabian Gulf with impunity. The money to pay for the weapons moved through offshore banks.

My own personal experience with embargoes came when I worked for the Senate Foreign Relations Committee in the late 1980's. We ran hearings on the drug trafficking activities of General Manuel Noriega. We showed that he had been involved with the transshipment of weapons to the Marxists in Nicaragua and the revolutionary groups in Colombia. We also showed that the Cubans used Panama to run Cuban goods, notably seafood into the U.S.

The administration imposed economic sanctions on Panama. After they were imposed, our Subcommittee asked GAO to evaluate the effectiveness of the sanctions. GAO concluded that they were worthless. Various industries had successfully lobbied for exemptions from the regulations. As a result, the regulations were riddled with loopholes. At the same time OFAC did not have any meaningful enforcement capability. The regulations did not change Noriega's policies, and as you will recall, it took an invasion to get him out of office.

The enforcement of sanctions and embargoes fall on OFAC which has been chronically understaffed. It has relied on financial institutions to self report violations and to freeze the funds which are involved in potentially illegal transfers. The bank self-reporting activity and the related seizures and freezes have generated impressive statistics for OFAC, but most of the activity relates to efforts by citizens of the embargoed country who are living here to send money home to their relatives. The serious dollar transactions which finance weapons programs and which would be illegal in the U.S. have moved offshore into foreign banks and alternative clearing mechanisms.

In sum, I believe that broad economic embargoes are dubious. They are impossible to enforce, they impose significant burdens on financial institutions and produce little in the way of results.

When the emotional satisfaction of passing embargo legislation into law fades, government officials and the business community are left with the sober reality that the embargo might harm American interests more than they harm the designated target. This leads to what I call “wink and nod” embargo evasion. Prohibited business gets moved offshore to foreign “independent” companies. U.S. firms change into foreign firms. Commodities are sold and resold to the point where they lose their identity.

In the end, the threat of a negative impact leads to contradictions in policy which would be otherwise inexplicable. For example, the U.S. government believes that it is in the U.S. national interest to have all international oil business done in dollars. If the embargo of Iran is too effective, Iran might well decide to sell its oil for Euros. Thus, the Federal Reserve Bank of New York allows the Iranian Central Bank to clear dollars and helps the independent dollar clearing mechanism put in place by other Asian governments including the embargoed government of Myanmar. All of this takes place “underneath the radar” of Congressional oversight or public opinion.

As an alternative to embargo and sanction legislation I propose the use of already existing Patriot Act tools to identify, trace, and disrupt the trade in nuclear bomb making tools and components, precursor chemicals for chemical warfare agents, and illegitimate trade in biological agents. At this point, there should be special focus on WMD delivery system components and related materials. Even if a country has assembled a bomb, it may still be possible to limit its ability to use it. To accomplish this, I would focus on enforcing customer identification procedures and suspicious activity reporting requirements in connection with commercial transactions. This flow of information, properly utilized, would allow a targeted use of economic and legal tools to limit and disrupt illicit trade.

As part of this approach, I would ask the cooperation of the Financial Action Task Force and the European Union.

The best example of how this approach works is the skillful way the Treasury Department forced the hand of the North Korean government by freezing the assets of the Macau Bank, Banco Delta Asia. The bank was a major mover of U.S. dollars for the North Korean regime. The North Korean funds on deposit there were seized as the proceeds of crime. The relatively limited seizure crippled the ability of the government and its top leadership to keep operating as a criminal enterprise. As a result they came to the negotiating table.

All financial institutions are presently required to file suspicious activity reports. These reports go to FINCEN which in turn passes them on to law enforcement and intelligence agencies. FINCEN and the related FINCEN “customers”, especially the intelligence community staffs who track weapons of mass destruction, should be telling financial institutions what kind of financial transactions would be related to the financial side of the WMD business. Those institutions could

then be asked to file reports when they spot the defined transactions. All of this is spelled out in Section 314 of the Patriot Act.

For example, if a manufacturer of centrifuges in Germany receives deposit money from an offshore shell company through a U.S. Bank, the wire should trigger a SAR. If the same manufacturer ships his products to a free trade zone, under a documentary letter of credit the banks involved in the transaction should be required to know their customers, note that this equipment does not go to an end user there, and file a SAR.

Letters of credit are included in suspicious transaction reporting requirements and customer identification requirements, but because the regulations allow institutions to base transaction monitoring on the level of risk, many institutions do not monitor the transactions because they consider commercial trade financing low risk and not worth monitoring.

On the government side of the equation, all of the intelligence people who follow WMD issues should be aware that each movement of goods has a related financial transaction. Each payment of a bribe for information or access to prohibited material leaves a financial trail. The intelligence analysts should be trained to follow the money trail.

Inasmuch as most of the supplies used to manufacture WMD come from countries with export controls, the export control machinery can be used to shut down the shipments and punish the suppliers and the shippers.

Existing law is more than adequate to deal with the problem of proliferation. The issues are intelligent use of the information generated by the present system and intelligent use of the tools available to freeze funds and control transactions. However emotionally satisfying new legislation might be, it will not make much difference and it will impose costs and an additional burden on financial institutions.

Finally, I urge you to consider the problem of "free trade zones." These zones make their living off the repapering of cargoes, re-invoicing to avoid customs and taxation, and as the perfect place to transship weapons of all kinds. In a world of terrorist threats, nuclear proliferation, potential dirty bombs and dangerous cargoes, it seems mad to leave large holes in the system. If the point of a free trade zone is to avoid taxation on re-manufacture, or to break bulk on a shipment, there is no reason incoming and outgoing cargoes cannot be inspected and documented. It is almost as if these zones were invented to make mockery of the global regimes to control the weapons trade and to limit proliferation.

Mr. SHERMAN. You can be sure that we will be asking that question. Long ago I gave an opening statement to these hearings in which I called for us to stop doing U-turn transactions for all Iranian banks, which I realize is just an inch away from your comment. I also want to point out that when it comes to nonproliferation, which is the core of what our subcommittee focuses on, there are really two ways to deal with regimes that are proliferating.

One is through invasion. Another is through sanctions. When it comes to invasion, we are 0 for whatever, including Iraq, and when it comes to sanctions, the only success really that we have had was in getting a country to give up nuclear weapons is South Africa, and that is attributable, I think, to worldwide sanction program.

But I want to go on to welcome David Asher, Senior Associate of The Heritage Foundation. I am going to guess that you are Mr. Royce's witness. From 2001 to 2005, he served as Senior Advisor to the Assistance Secretary of State for East Asian and Pacific Affairs, and he also served on the United States delegation as an advisor to that delegation to the Six-Party Talks with North Korea. Mr. Asher.

**STATEMENT OF DAVID L. ASHER, PH.D., SENIOR ASSOCIATE  
FELLOW, THE HERITAGE FOUNDATION**

Mr. ASHER. Thank you, Chairman Sherman and Ranking Member Royce, Congressman Manzullo. I appreciate the opportunity to be here today. In addition to working on the diplomatic track as Jim Kelly's advisor in the Six-Party Talks, I reported to Deputy Secretary Armitage and to Secretary Powell and coordinated the North Korea Working Group that was called the NORCAG, the North Korea Activities Group which is an interagency effort involving 14 different U.S. Government agencies and departments and over 200 policymakers, intelligence analysts, and law enforcement officers with one goal: To try to impede North Korea's global weapons proliferation networks, their illicit trading networks, some of which are linked together, and their finances.

The illicit activities initiative prominently involved the use of several and the development of the conceptualization of the use of several of the tools you are discussing today including the USA Patriot Act Section 311 which we worked hand-in-glove with Treasury Department to apply and planned to apply against North Korea, and after a time of deep research we came to conclude that one of the best spots was in Macau against Banco Delta Asia.

Whatever one's perspective on Banco Delta Asia, I believe the use of Section 311 was very effective in containing North Korea's weapons proliferation, illicit trading networks, and it demonstrated to the regime that such activities are not a sustainable or acceptable way of supporting their existence in the world, and in that context I feel they did contribute to the Six-Party Talks.

But we designed this initiative with the goal of countering these activities themselves and the people that are involved in them, not necessarily just supporting the Six-Party Talks. We did not design the initiative to give it away, and for that reason I am concerned about the illicit funds that were frozen at Banco Delta Asia upon our request of Macau authorities being handed back to North Korea.

Even as an act of diplomatic active expedience and a form of diplomatic concern with negotiation of North Korea for expediency in the right circumstances, this strains one's litmus test of what is reasonable, and it certainly contradicts the spirit and the letter of the laws that we have invoked in the international agreements that we have actually cosponsored regarding North Korea's proliferation such as U.N. 1718.

North Korea is a nation whose profits in illicit trade may in many years exceed what it earns in legal exports. It is a nation that has to learn that if it wants a normalized relationship with the United States, something it says is its top priority, in the context of denuclearization, it has to ban in government directed criminal activities including the counterfeiting of our dollar and weapons proliferation to state sponsors of terror like Iran. These are not peripheral objectives. They are very much at the heart of what we are doing.

In my view we could have offered North Korea \$250 million in development assistance to help improve some aspect of its bankrupt economy in order to get the talks going but never should have allowed \$25 million in clearly illegal money or money linked to illicit perpetrators to be handed back. This action placed the North Korea's few remaining strengths as a nuclear arm dictatorship not the many we enjoy as a nation of freedom and laws.

Some have asked me—many asked me—how freezing \$25 million at a little bank in Macau could cause such a disruption. There are two reasons, both of which we clearly conceptualized in planning the action. The first is that the 311 in position drove a wedge between North Korea and Macau. Until September 15, 2005, when the action was taken, DPRK had for decades enjoyed a protective relationship with Macau's Government and many of its business leaders and political leaders that reached far beyond Banco Delta Asia.

Not only was Macau a global center for North Korean proliferation and for illicit activities, it also was a central node for managing the finances of the kleptocratic finances of Kim Jong Il. This sounds a little bit exaggerated, but the fact is the South Korean Government alone poured something on the order of \$500 million in bribes in order to obtain the 2000 summit, and they have investigated—this has been prosecuted in their courts—into banks in Macau in bank accounts which one would assume are controlled by Kim Jong Il. That was certainly what they assessed.

So losing ready access to Macau imposed a huge cost on North Korea. The other reason was that it was more than \$25 million at BDA that was frozen in September 2005. Essentially North Korea was frozen out of the international financial system. It was sort of a shot heard round the world for international bankers who cut off relations with North Korea fearing that something like what happened to BDA could happen to them.

In addition, banks under know your customer rules took it under themselves to start to freeze or to impede access to accounts globally. I have talked to many bankers about that. They have told North Koreans we are going to cut our business relations with you. We are not going to wire the money out of the country. If you want access to it, you have got to present yourselves. The same thing is

happening at Banco Delta now. North Koreans who were involved in illicit activity are leery to present themselves to withdraw funds. So this has really crimped their style, and it has had a very important impact on impeding their proliferation potential.

In closing, the BDA issue is said to be settled. My former colleague, Chris Hill, has said that the issue is settled by the recent reversal in policy. However, the reality is from North Korea's perspective and from ours is that until North Korea starts to act as a normal, transparent, law-abiding member of the international financial system and indeed the international community, it is going to continue to be punished by the legacy and the continuity of its own illicit actions.

It is really in their court. They are the ones that are the masters of their own situation, and you know of course we hope that this action by having been made permanent against Banco Delta, they are not going to undo that, they may have unfrozen the money, will serve as a inspiring legacy to get North Korea to behave better both diplomatically and as a player in the international system. Thank you.

[The prepared statement of Mr. Asher follows:]

PREPARED STATEMENT OF DAVID L. ASHER, PH.D., SENIOR ASSOCIATE FELLOW, THE HERITAGE FOUNDATION

Chairmen Sherman and Gutierrez, ranking members Royce and Paul, I am honored to testify before this important joint hearing today. From 2001–2005 I served as the Senior Advisor for East Asian and Pacific Affairs at the Department of State and Coordinator of the North Korea Working Group, the task force on North Korea under the Office of the Secretary. I also co-chaired a special principal's coordinating committee for the National Security Council, the North Korea Activities Group.

In early 2002 I was tasked by Assistant Secretary Kelly and Deputy Secretary Armitage to put together a State Department-led effort to analyze, investigate, and then counter North Korean illicit activities. The effort eventually became known as the Illicit Activities Initiative (IAI).

The IAI was never designed as a substitute for diplomacy. Instead, we saw the IAI as an initiative that should be pursued for its own merits as well as potentially serving as an adjunct element to our diplomatic efforts. Our objectives were three-fold:

1. Apply Law enforcement for its own sake (our laws were being broken and our currency counterfeited; a vigorous response was needed),
2. Cut off illicit support for the regime (hoping this would steer them toward cleaner sources of support in cooperation with the members of the Six Party talks), and
3. Contain the threat of proliferation by restricting the access of weapons trading companies to the international financial system as well as disrupting their business operations and support networks globally.

The IAI eventually came to involve 14 different US government Departments and Agencies and around 200 officials, analysts, and law enforcement officers. Between 2003 and 2005 we briefed and enlisted the cooperation of over 15 different governments and international organizations. We also worked closely with private industry participants drawing on their independent investigations into high income producing areas for the military and Pyongyang elite, such as the counterfeit cigarette and counterfeit pharmaceutical businesses.

In the area of counter-proliferation our mandate was to pursue the disruption of weapons trading networks via law enforcement methods. For example, we worked with partner countries, such as Japan and Taiwan, to help them identify and investigate trading companies involved in North Korean proliferation, arrest their senior management, freeze their assets, and put them out of business once and for all.

The IAI also prominently involved the use of several important legal provisions that this hearing is reviewing, including the use of Section 311 of the USA Patriot Act. The decision to use Section 311 of the Patriot Act against Banco Delta in Macau remains controversial. Some question its timing, believing it disrupted the

Six Party Talks, while others credit the action with getting the DPRK to sign on to the September 19, 2005 denuclearization plan to begin with and now bringing them back to the table after a long boycott. Whatever one's perspective on BDA, I believe the use of Section 311 was extremely effective both in containing North Korea's weapons proliferation and illicit trading networks as well as in demonstrating to the regime that such activities are not a sustainable or acceptable means of supporting the DPRK state.

Today many of us are concerned with the way that illicit funds that had been frozen at Banco Delta have been returned to the North Korean perpetrators or financial beneficiaries of these activities as a means of getting the DPRK back to the negotiating table in the Six Party Talks. Even as a diplomatic act of expediency this strains one's litmus test of what's reasonable and contradicts the spirit and possibly the letter of our laws we have invoked and international agreements we have vociferously supported, such as UN Resolution 1718. North Korea, a nation whose profits from illicit trade in some years may exceed what it earns in legal exports, has got to learn that if it wants to eventually enjoy normalized relations with the United States—something it says is its top priority—it must *act normal* and abandon government directed criminality and proliferation to state sponsors of terror as well as give up its nuclear weapons and programs. The frozen funds in Macau served to reinforce this message which is at the core of potential improved relationship with North Korea, not at its periphery. We could have offered North Korea \$250 million in development assistance to help improve some aspects of its bankrupt economy but never should have allowed \$25 million in dirty money to be handed back. This action played to North Korea's few remaining strengths as a nuclear armed dictatorship, not the many we enjoy as a nation of freedom and law.

Some wonder how freezing \$25 million dollars at a small bank could cause such a disruption. There are at least two reasons, both of which we had clearly conceptualized in planning the action. The first is that the 311 imposition served to drive a wedge between North Korea and Macau. Until September 15, 2005, the DPRK had a protected relationship with Macau's government and many of its business leaders that reached far, far beyond BDA and its management. Not only was Macau a global crime center for North Korea (something that has been thoroughly documented by US law enforcement investigations), it served as a central hub for the DPRK's weapons proliferation. It also was a critical node for the management and investment of Kim Jong Il's huge kleptocratic fortune—which reportedly reaches into the billions of dollars. Losing ready access to Macau imposed a huge cost on North Korea.

The other reason is that it was far more than the \$25 million at BDA that was frozen in September 2005. North Korea was, in effect, frozen out of the international financial system as banks around the world suspended business relations with it. Moreover, one can only assume that much more than \$25 million is likely to have been frozen, immobilized, or impeded in Macau and elsewhere.

Certainly in discussions with Chinese authorities, as with all other foreign governments, we had repeatedly asked them to investigate and, where appropriate under criminal statutes or anti-money laundering rules, freeze funds tied to North Korean illicit activity. Perhaps, fearing that the Treasury would expand the 311 designation to cover other much more important banks in Macau or even to the domicile itself, they took broader action. One would hope so.

In closing the BDA issue is said to have been "settled" by the recent reversal in policy. However, the reality is that its effect will linger until North Korea demonstrates that it can and will operate as a normal, transparent, rule-abiding member of the international financial system and indeed of the international community writ-large. Thus while I am dismayed that the BDA funds decision has been reversed, I am much more dismayed by the way North Korea continues to be able to use crime and nuclear coercion for profit, unfortunately including in the Six Party Talks.

Mr. SHERMAN. Thank you. Lastly, a very patient Victor Comras, who led the U.S. State Department's Foreign Policy Trade Control and Sanctions programs for nearly a decade. In addition to serving as a member of the United Nations al-Qaeda monitoring group, he is a noted authority on al-Qaeda and terrorism financing. His articles have appeared in a number of publications, including the *Washington Post* and the *Financial Times*.

**STATEMENT OF VICTOR COMRAS, ESQUIRE, THE EREN LAW FIRM (FORMER MEMBER OF UNITED NATIONS AL-QAEDA MONITORING GROUP)**

Mr. COMRAS. Thank you very much, Mr. Chairman. Thank you for inviting me here to discuss my views on sanctions as a tool to dissuade—

Mr. SHERMAN. You may want to turn on your microphone.

Mr. COMRAS. Right. I am all set now? Good. Thank you, Mr. Chairman, for inviting me here to talk about how sanctions can be used to dissuade Iran and North Korea from their current nuclear proliferation policies. I have long been an advocate of using well considered, targeted economic and political sanctions to dissuade Iran and North Korea from pursuing their irresponsible nuclear development programs.

Sanctions are coercive measures. They are supposed to have an impact. They are meant to pressure a regime to conform to specific norms. Sanctions fail when the costs that they impose are simply not persuasive. Iran will only change course if and when its leadership is convinced that the international community will in fact take the steps necessary to seriously impact Iran, its very vulnerable economy, and its leaders personally.

Iran's leaders know that serious economic sanctions would have serious consequences for the stability and the durability of their regime. Unfortunately the sanctions placed on Iran to date by the Security Council do not amount to much. They convey the message that key countries simply continue to lack the political will necessary to face up to Iran's challenges. Beyond freezing the assets of some 30 or so individuals and entities and banning the purchases of Iranian arms, the sanctions do very little to impact Iran's economy or to cut the flow of sensitive arms equipment and technology to Iran.

Each country under these sanctions continues to remain free to decide for itself what is sensitive military equipment and technology and what they should no longer provide. The resolution only calls on them to exercise restraint and vigilance when it comes to providing Iran with sensitive dual use items or from stopping key Iranian military and industrial officials from visiting their countries.

These measures are not obligatory, and the resolution continues to allow countries to provide Iran with developmental assistance and with commercial term loans and investments.

This leaves Russia a free hand to pursue its ambitious multibillion-dollar trade program with Iran. It leaves on the table several major oil and gas development programs including a potential \$10 billion investment by Royal Dutch Shell and a Spanish oil company, Repsol, to develop Iran's South Pars field. It also leaves on the table the multibillion-dollar construction of an LPG export plant by Total and a \$20 billion investment by SKS Ventures of Malaysia.

It does nothing to deal with the multibillion, up to maybe a \$100 billion, over the next 25 years worth of deals being negotiated between China and Iran. Against this background, Mr. Chairman, how can any of the U.N. sanctions measures really be taken seriously?

I believe that we should now adopt a much more aggressive strategy in favor of effective sanctions on Iran, sanctions that are directed specifically at Iran's economic and political vulnerabilities. We should proceed concurrently on two tracks. One, we must continue to press for stringent Security Council sanctions, sanctions that include accelerating measures that will isolate Iran and cut off Iran's access to capital equipment and financial resources. Such investments should be tied to benchmarks, as they have been in the past, including discontinuance of its enrichment program, transparency and IAEA inspections.

We must at the same time, Mr. Chairman, develop a common front with Europe and with Japan to act together even in the absence of Security Council action. Europe, along with Japan, holds the key, Mr. Chairman, to these sanctions. Any real successful sanctions must involve them. They represent Iran's most important trading partners and the most important source for Iran to obtain critical energy sector capital equipment, technology, and investment.

Iran's growing commercial class which now plays a critical role in providing employment opportunities in Tehran and Iran's other major urban centers is particularly reliant on the trade with Europe and Japan, and the threat of concerted action by Europe and Japan to reduce or cut off a significant part of this trade will place great stress on this commercial sector, and that would likely have a major impact on Iran's future policy calculations.

Ironically, Iran is a major importer of gasoline, some 180 million to 200 million gallons per month. This gives us another opportunity to target sanctions. Royal Dutch Shell now serves as an advisor to Iran on how they can increase their local refining capabilities. That should be halted.

Iran's banking sector has been discussed by many of my colleagues. It is notorious for its failures to comply with international anti-money laundering, fraudulent, and corrupt practices and counterterrorism requirements. Yet they still get a free hand to internet with most of the world banking community.

We should freeze the assets of those involved in Iran's Revolutionary Guards as well as its clerical presidential and parliamentary leaders. These are steps that I believe that can and should be taken. But to date Europe has given Iran a free hand. They have used loud words but there have not been any real actions. And, they have taken no measures that will demonstrate to Iran how serious they are in stopping them from acquiring nuclear weapons capability.

Our task now is to convince the European countries to get tough with Iran. Thank you, Mr. Chairman.

[The prepared statement of Mr. Comras follows:]

PREPARED STATEMENT OF VICTOR COMRAS, ESQUIRE, THE EREN LAW FIRM (FORMER MEMBER OF UNITED NATIONS AL-QAEDA MONITORING GROUP)

Thank you, Mr. Chairman for inviting me to share my views on the use of sanctions to dissuade Iran and North Korea from their current nuclear proliferation policies. I don't think there can still be any doubt that Iran's current nuclear program, and particularly its uranium enrichment program, is directed at establishing a nuclear arms capability. And, I believe, that if Iran is allowed to succeed, and if North Korea is allowed to maintain its nuclear weapons program, that the implications for

international peace and security, and for keeping the lid on future nuclear weapons proliferation, are devastating. The stakes here are very high.

I have long been an advocate of using well considered targeted, economic and political sanctions to dissuade Iran and North Korea from pursuing their irresponsible nuclear programs. By well considered I mean sanctions tailored to achieve specific objectives by having a significant impact on those individuals or entities, and/or specific segments of the targeted country's economy or body politique, that are likely to influence the course of conduct in question. I believe that the credible threat or use of such sanctions offers us the best chance of convincing these countries to change course without having to engage in costly and dangerous military action. I do not believe that the current sanctions programs in place with regard to Iran or North Korea meet this criteria.

The North Korea and Iran situations are quite different, and require separate analysis. Each is vulnerable to sanctions in different ways and the sanctions used should be tailored specifically to these vulnerabilities. I will address them separately. Let me start with Iran.

One can certainly understand the reluctance and caution on the part of the international community when it comes to imposing sanctions on Iran, given Iran's importance as a supplier to the world oil market. And with oil now selling for more than \$60 per barrel, reducing Iran's flow of oil onto the market could drive the price much higher. But, the costs and dangers incurred by posing a credible threat of well targeted and effective sanctions against Iran now would be considerably less severe than having to resort to a comprehensive embargo and/or military action in the future. And everyday we stand down now serves only to strengthen Iran's resolve to forge ahead making further confrontation increasingly inevitable, and at a higher cost.

Let's be clear. The low-impact sanctions now on the table simply will not work. The sanctions measures so far adopted by the Security Council have already proved insufficient to motivate Iran to curtail its enrichment activities, and have led, in fact, to its acceleration. Rather than demonstrate the international community's commitment to forcing Iran to halt its nuclear arms program, they have conveyed the sense that key countries lack the political will necessary to face up to Iran's challenge to non proliferation norms. And this signal has been received loud and clear by the current Iran regime. Iran will only change course if and when its leadership is convinced that the international community will, in fact, take the steps necessary to seriously impact Iran's leaders and its very vulnerable economy. Such an impact on Iran's economy, Iran's leaders know, would, in turn, seriously threaten the stability and durability of their regime.

And Iran has already discounted the credibility of future, more stringent sanctions coming from the Security Council. They count on the fact that both Russia and China have vested interests in expanding energy trade relations with Iran, and that Europe and Japan will be unwilling to impose meaningful sanctions on their own. They have good reason to expect that the next and future rounds of sanctions will be as hesitant, incremental and meager in nature as those currently in place. For this is precisely what has occurred since the first threats of sanctions were issued following the IAEA's resolution, in August 2004, condemning Iran's nuclear program as a clear violation of IAEA non proliferation commitments. Despite these previous threats of sanctions no actions were taken for over two years, and not until December 26, 2006 when the Security Council, with resolution 1737, finally imposed a muffled set of weak measures directed against only a handful of individuals and entities directly tied to Iran's questionable nuclear program.

Resolution 1737 directed all countries to freeze the assets of only some 10 Iranian entities and 12 individuals directly involved in Iran's centrifuge programs, its heavy water reactor at Arak and its pilot uranium enrichment plant at Natanz. The resolution also imposed a limited ban on materials and technology that could contribute to "enrichment-related, reprocessing or heavy water related activities, or to the development of nuclear weapons delivery systems." But, these same items supposedly had already long been restricted under various international agreements such as the Nuclear Suppliers Group, the Wassenaar Agreement and the NPT itself. Surprisingly, the resolution allowed Iran to continue to import equipment and technology for other light-water reactors and for low-enriched uranium contained in assembled nuclear fuel elements. It simply exempted the \$800 million light-water reactor built for Iran by Russia at Bushehr from its application.

And resolution 1737 also provided little scope for any actual enforcement. It left each country free to interpret these restrictions for itself and to determine on its own which items must be barred. The only requirement is that they inform the Security Council of any dual use items that they actually do export to Iran.

Except for its harsh rejection of resolution 1737, Iran took little notice.

On March 23rd, 2007 the Security Council passed a second set of sanctions supposedly to ratchet up the pressure on Iran. But they really have not had such effect. The additional measures in resolution 1747 include:

(1) The addition of some 28 individuals and entities to the list of those whose assets are to be frozen. Many of these additional individuals and entities are associated with military aspects of Iran's nuclear program, including delivery systems. Few, if any, maintain bank accounts overseas, and there are no reports, so far, of their assets being frozen. Of some note, however, is the addition of Iran's fifth largest bank, Bank Sepah, which along with Bank Sepah International, plays a key role in bankrolling Iran's missile and aerospace programs. This may be the only really significant measure taken so far against Iran. The United States had already designated Bank Sepah on January 9th, 2007 stating that "Bank Sepah is the financial linchpin of Iran's missile procurement network and has actively assisted Iran's pursuit of missiles capable of carrying weapons of mass destruction." The resolution now requires that all countries direct their financial institutions to stop dealing with this bank.

(2) A ban on Iranian sales and exports of arms and military equipment. Iran now sells arms to very few countries in the Middle East and Africa, including Sudan, Hezbollah, and certain Shiite and Sunni factions in Iraq, are also recipients of Iranian arms, but these covert supply routes are unlikely to be affected by the new resolution. It is also unclear if the resolution applies to current arms purchase contracts or only to future contracts.

Beyond these "obligatory measures," the resolution only "calls upon" all countries to:

(3) "*exercise vigilance and restraint*," when it comes to providing heavy military arms and equipment to Iran, including "battle tanks, armoured combat vehicles, large calibre artillery systems, combat aircraft, attack helicopters, warships, missiles or missile systems."

(4) "*exercise vigilance and restraint*" when it comes to allowing specified Iranian military officers and nuclear scientists and engineers visit their countries; and,

(5) not to engage in new commitments for grants, financial assistance, and concessional loans, to the government of Iran, *except if they are to be used for humanitarian or developmental purposes.*

It is noteworthy that the resolution does not contain any cautionary suggestion when it comes to providing financial or other support or assistance for commercial investments with the Iranian government, including investment in Iran's key energy sector. This leaves on the table several major oil and gas development projects including a potential \$10 billion investment by Royal Dutch Shell and the Spanish oil company Repsol YFP to develop Iran's South Pars field, the construction of a multi-billion LPG export plant by Total, and a \$20 billion investment by SKS Ventures of Malaysia to produce national gas in Iran's Golshan and Ferdow fields. Three years ago, in March 2004, China's state-owned oil trading company, Zhuhai Zhenrong Corporation, signed a 25-year deal to import 110 million tons of liquefied natural gas (LNG) from Iran. This was followed by a much larger deal between another of China's state-owned oil companies, Sinopec, and Iran, signed in October 2004 which allows China to import a further 250 million tons of LNG from Iran's Yadavaran oilfield over a 25-year period. This huge deal also will enlist substantial Chinese investment in Iranian energy exploration, drilling and production as well as in petrochemical and natural gas infrastructure. Total Chinese investment targeted toward Iran's energy sector could exceed a further \$100 billion over 25 years.

The resolution also leaves Russia a completely free hand to pursue its own ambitious Iran trade promotion policy aimed at increasing bilateral trade between the two countries by some \$10 billion over the next five years.

*Against this background, how can any of these UN Security Council sanctions measures be taken seriously?*

The Security Council has used sanctions on numerous occasions to deal with or dissuade egregious state actions. These sanctions programs have had various degrees of success. Some sanctions programs, such as those against Serbia and Libya proved key to resolving problematic international crisis. The application of sanctions against South Africa and Rhodesia also led to profound changes in the domestic policies of these countries. But, the measures so far adopted against Iran stand out singularly as *the weakest and most timid response* the Security Council has ever made in dealing with such a high profile and potentially egregious disturbance to international peace and security.

I am deeply concerned also with the way the Security Council has formulated these measures against Iran. In order to achieve consensus they have simply set the sanctions bar too low—both in terms of its impact and its enforcement—to have any effect. The Security Council should always avoid adopting measures that they already know, in advance, are unlikely to achieve any of the stated objectives. Such action serve only as an “empty gesture” or “excuse” for non-action on the part of the Security Council, and by others who are using the Security Council measures merely as an excuse for not taking any action themselves. This serves only to diminish the credibility of the Security Council and the effectiveness of sanctions as an effective foreign policy tool.

The use of new terminology in the Iran sanctions resolutions which merely calls on states to “*exercise vigilance and restraint*” when it comes to halting the flow of heavy arms and military equipment, including missiles to Iran, or to restricting the travel of key nuclear and military personnel, is particularly ludicrous and disturbing. Why not ban such trade and travel outright? Hopefully, such provisions will not become standard fare when it comes to future sanctions resolutions.

It is already clear from Iran’s reaction to the new sanctions that much more will be required. So what should we do?

There are many nay-sayers who warn that sanctions can never work against Iran given its important geo-economic position as a major market and oil and gas supplier. They argue that meaningful sanctions against Iran are just unattainable as they would wreak havoc on a world energy-reliant economy. If one accepts this thesis one must also be driven to the conclusion that the unilateral US sanctions that the US has imposed on Iran for all of these years has served no real purpose, and that it has been more harmful than helpful to overall US interests. I have heard these same arguments made with regard to sanctions on Serbia, Iraq, Libya and South Africa. In each of these cases, the nay-sayers were wrong. While it is evident that gaining acceptance for effective sanctions on Iran will pose extra ordinary challenges, these challenges are worth pursuing, especially given the high stakes involved.

Iran’s economy is already very fragile and vulnerable to trade restrictions. Oil accounts for around 80 to 90 percent of Iran’s total exports and 40–50% of the government’s budget. Despite high oil prices, Iran’s economy has softened considerably since President Ahmadinejad took office. Unemployment is rampant and new investment in Iran’s industry, commercial sector and infrastructure has stalled. Substantial new foreign capital investment is also needed to modernize its petroleum infrastructure and to meet growing domestic energy demands while maintaining revenue producing oil exports. Iran’s leaders can ill-afford to aggravate Iran’s economic distress further.

I believe that we should now adopt a much more aggressive strategy in favor of effective sanctions on Iran—sanctions that are directed specifically at Iran’s economic and political vulnerabilities.

We should proceed concurrently on two different fronts. On the one hand we must continue to press for more stringent Security Council action. This should include accelerating sanctions aimed at isolating Iran and cutting off Iran’s access to capital equipment and financial resources to develop further its very important oil and gas sector. Such investment should be tied specifically to benchmarks including discontinuance of its enrichment program, transparency and IAEA inspection. Sanctions should also increasingly target Iran’s very vulnerable commercial class, threatening to cut them off from access to goods and services, including financial services.

Ironically, Iran, which is such a major exporter of oil and gas, is, itself a major importer of gasoline and other finished petroleum products. With a daily consumption of more than 18 million gallons of gasoline Iran must now import some 180 to 200 million gallons of gasoline per month. Rising petroleum prices have already been the cause of civil unrest, and gasoline shortages could have a significant impact on local business activity and put increased pressure on Iranian leaders to alter course. Royal Dutch/Shell is now serving as an advisory partner with Iran in an assessment project to upgrade Iran’s refining capacities. This is the kind of activity that should be halted.

Iran’s banking sector is already notorious for its failures to comply with international anti-money laundering, fraudulent and corrupt practices, and counter-terrorism financing norms. Yet, Iranian banks continue to have broad access to, and to network through, the international financial and banking sectors. I believe new efforts should be taken to isolate Iran’s banks and to assure that all transactions stemming from, or destined to or through Iranian banks be subjected to close regulation and scrutiny. Such action would also bring home to Iran a significant cost for the irresponsible policies it is pursuing.

Finally, special measures should be adopted which specifically freeze the assets and financial transactions of Iran's Iranian Revolutionary Guard Corps (IRGC), as well as its clerical, presidential and parliamentary leaders. The IRGC's business and industrial activities are heavily engaged in Iran's energy sector and its engineering arm, the Khatam-ol-Anbia, has been the beneficiary of numerous oil and gas development related contracts. Iran's governing class has also been notorious for its corrupt practices including involvement in, and kickbacks from, Iranian and foreign companies engaged in Iranian commercial and developmental projects. For their part, Iran's Mullahs, many of whom reportedly have large caches of funds overseas, may also provide useful sanctions targets.

A new UN resolution should also encourage other oil producing countries to act to rationalize the oil market in anticipation of further sanctions against Iran. Further measures, including a ban on oil exports, should be envisaged if Iran continues to resist compliance with IAEA norms.

At the same time as we pursue opportunities to strengthen UN measures against Iran we should also seek expanded bilateral support and commitments from our friends and allies to increase the pressures on Iran.

We must develop a common front with Europe and with Japan, to act together, even in the absence of Security Council action, to impose serious economic and trade measures that will bring real costs to the Iranian economy. Such non-security council sponsored sanctions have been used successfully before by the United States and our European allies, as in the case of Serbia during the Kosovo war. They are certainly merited now.

Europe along with Japan holds the key to any really successful sanctions actions against Iran. Europe together with Japan are still Iran's most important trading partners, and the most important source for Iran to obtain critical energy sector capital equipment, technology and investment. They also provide Iran with critical commercial and developmental investment and assistance. In fact, Iran now imports more from Europe and Japan than it exports to them in terms of oil supply. Iran's growing commercial class, which now plays a critical role in providing employment opportunities in Tehran and Iran's other major urban centers, is particularly reliant on this trade with Europe and Japan.

The threat of concerted action by Europe and Japan to reduce or cut-off a significant part of its trade and investment activities in Iran, and to place great stress on Iran's commercial sector, would likely have a major impact on Iran's future policy calculations.

But, Europe has, so far, given Iran a free pass, using loud words, but no real action, to convince Iran to change course. Europe's negotiating package with Iran already contains a very large number of attractive carrots, but it is woefully short when it comes to the sticks. This must change.

Alone the United States has little sanctions leverage left on Iran. The US has barred most trade and investment with Iran, including the purchase of Iranian oil since 1995. But, we are still the major player in the international economy, and our own economic, trade and financial policies can have a major impact on the cooperation and conduct of others. Our task now is to convince European Countries Union to get tough with Iran and to get their companies and financial institutions to refrain from entering into new deals or making further capital investment commitments in Iran until Iran complies with the UN's non proliferation resolutions. Beyond that, we can use our combined economic clout with Europe and Japan to retain pressure on Russian and China not to undercut these sanctions measures. Ultimately, China and Russia must be convinced to join with the community of countries that will refuse to deal with Iran so long as they pursue an unacceptably dangerous road toward the development of nuclear weapons.

Let me turn now to North Korea

While the threats posed by North Korea's nuclear weapons program are as grave, and perhaps even more acute, as that posed by Iran, the situation we face in North Korea is markedly different.

North Korea is among the poorest countries on earth, completely lacking in foreign investment and heavily dependent on foreign assistance. It is tightly ruled by a small clique whose interests have been defined as quite distinct from the country's general population. And any North Korean decision to reverse course on nuclear weapons would entail little controversy or consequences for its leadership. When it comes to sanctions the country's perceived vulnerabilities are truly quite distinct from those in the Iran situation.

United Nations Security Council Resolution 1718 was meant to send a strong message to North Korea that the international community will not contenance continuation of their ballistic missile and nuclear weapons development and testing programs. It showed that the international community stands behind efforts by the

United States, China, Japan, Australia and South Korea to convince North Korea that it has more to gain, than lose, by abandoning its nuclear weapons program.

While the language contained in the North Korea sanctions resolution is quite strong and to the point, the sanctions measures adopted are considerably weaker. They impose a very limited embargo on a small range of heavy military equipment, and high technology items and commodities associated with North Korea's nuclear and ballistic missile programs. The resolution ostensible also threatens to cut off the flow of "luxury goods" to North Korea's leadership. But, the only measure that really captured North Korea's leader's attention were the measures directed at freezing assets and bank accounts held overseas by North Korea's leaders. North Korea has insisted that the US allow funds frozen in the Macau-based Banco Delta Asia (BDA) bank to be released as a precondition for Korea's carrying out steps promised in a accord reached in six party talks last February. This includes North Korea's agreement to seal the Yongbyon nuclear reactor by April 13th and to invite back the IAEA to oversee North Korea's compliance. North Korea has already missed this deadline, but has indicated that it remains committed to carrying out these actions.

When it comes to sanctions on North Korea, China is clearly in the driver's seat. The Chinese can determine what impact, if any, these measures will actually have on North Korea. They remain North Korea's principal market and principal supplier. The bulk of North Korea's imports and exports cross their common border. China's inspection of cargoes, and interdiction of contraband, are essential to making these measures work. But, even if these limited trade sanctions items are interdicted, the economic effect on North Korea will be minimal. China will have to go beyond these limited sanctions, and begin using its considerable economic leverage over North Korea, to keep them on track with their six party talks commitments.

I think it is premature to assess whether or not these sanctions, or more specifically the threat of these sanctions actually being enforced, will work. Except for the asset freeze little more has been done to put these measures in play. Nor do I have any great suggestions to offer on what we must do to get North Korea to comply fully with the terms of the Security Council Resolution—other than to suggest the obvious: We must encourage all countries, and especially China, to effectively implement these measures, if, in fact, North Korea backslides. And we must stand ready to consider how we can best keep China and South Korea committed to maintaining sufficient pressure on North Korea to make sure they move forward in closing down and dismantling their nuclear weapons related facilities.

Thank you, Mr. Chairman. That concludes my remarks.

Mr. SHERMAN. Thank you for pointing out the importance of the Security Council, the key to which I believe is Russia, and I will renew what I have said often in this room and elsewhere, and that is that we need talks with Russia about Iran. These are also all issue talks that involve the issues that Russia cares about in its own immediate neighborhood because without a change of Russian policy, you do not get a change of Russian policy, and you also do not get the U.N. Security Council sanctions that you are talking about. With that I would like to yield to the gentleman from southern Los Angeles and northern Orange County, Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman. I would like to go to Mr. Asher, and ask you, sir, if you could respond to the earlier panel discussion on North Korea. You were here at the time, and I very much concur with your remarks but I would like to give you a chance to respond to what was said especially regarding the release of the \$25 million.

Mr. ASHER. Well personally it is something that I think there are several reasons why it was not particularly expedient even though it was done for the sake of expediency. The North Koreans are looking to be accepted not for what they have to become in the international system but for the way they are.

You know they have not said that they are going to abandon even the counterfeiting of our dollar. They may be interested in obtaining bill detectors so that they can improve the quality of their counterfeit, and I believe personally that they likely will be making

efforts to develop ability to counterfeit our new bills which would mean that we have redesigned our dollars twice now because of North Korea. We might have to do it a third time if that happened.

Mr. ROYCE. What would happen if we just decided to implode that regime by responding to an act of economic warfare in a way that embargoed that system?

Mr. ASHER. I do not know that we need to go that far frankly at all but I just would not be accepting that.

Mr. ROYCE. Well we are not going to that step. They are the ones that have taken an act of economic warfare. This is the first time since the Second World War that one country has copied another country's currency, and what is unusual here is it is being done with impunity.

Mr. ASHER. And what I have a hard time is that we identified, my colleagues who have done a terrific job, I mean Danny Glaser has done a great job as Deputy Assistant Secretary, and I do not blame him.

Mr. ROYCE. Yes.

Mr. ASHER. He is doing what he is being told.

Mr. ROYCE. I do not blame him either.

Mr. ASHER. If there are proceeds of them counterfeiting the dollar and they are deposited with Banco Delta—and of course many other banks. Banco Delta was a symbolic target. We were trying to kill the chicken to scare the monkeys, and the monkeys were big Chinese banks doing business with North Korea, and we are not talking about tens of millions. We are talking about hundreds of millions of dollars. Okay. So that is important to understand.

And I think we did scare them, and it got them to start to cooperate much more importantly in law enforcement. The problem is we are sending back to North Korea exactly what they demanded. They want to be accepted as a country which can do these sorts of things and not pay the price. I am all for transformational diplomacy with North Korea but we should be again I said let us offer \$250 million in development assistance. We can build an American university in Chung Yang if we have to and educate the North Koreans about you know civil society. I am not against engagement.

But this caters to the worst elements inside North Korea, and it contradicts our policy, and I believe you know protecting the power and prestige of the United States of America I know is a critical concern for all of you, and this committee does a great job you know making sure that the administration and other past administrations have done this but we give up a lot after we have made a big deal about these illegal activities, and then we hand back criminal money, even if it was not technically us handing it back, and even if they did not technically hand it back to North Korea's Government, that money was associated with illegal income.

I am very confident, and it is controlled by the North Korean Government. They are just through proxies. So you know I think it is just not a constructive effort.

Mr. ROYCE. Thank you. One of the things Mr. Blum said was in regard to these free trade zones he said it is almost as if these zones were invented to make a mockery of the global regimes to control the weapons trade and to limit proliferation. I am inter-

ested in knowing what we can do about that in terms of the free trade zones and also as we go through the testimony and the arguments made by Mr. Comras.

I mean I think we all concur that, yes, Europe should be recognizing that even the market, the international market is reacting to the dangers of doing business in Iran, and is pulling back but not Italy or France or Germany that are continuing with these export credits and are insistent even when Britain makes the request that they are going to continue to have their taxpayers subsidize the risk of pushing business with Iran which otherwise would not occur in the market, and so my question goes to all right what do we do about these failings? How do we galvanize Europe? Do we do it through NGOs? Do we launch some kind of a PR campaign? I mean something has to be done here. Mr. Blum?

Mr. BLUM. The problem here has been that Iran has something that everybody needs including us, and that is oil, and that oil becomes a very potent bargaining tool no matter what a bunch of bums they happen to be. So somebody will jump in to do business with them. This has been going on in the politics of oil for at least 50 years where regimes that you would not otherwise look at for 2 minutes get away with all kinds of things.

Obiang in Equatorial Guinea is running an absolute monarchy police state, kleptocracy. We could go on and on. The truth is the world has no way to deal with what is essentially a criminal government that makes it as a sovereign state under the Treaty of Westphalia norms. So North Korea is a criminal enterprise masquerading as a state, and now it wants the same privileges as a state, and wants to negotiate its status as a criminal enterprise.

Genocide is not negotiable. Criminal enterprise should not be negotiable, and what do we do? And the only tools left are invasion or what? And if the state involved has something we need it is a terrible, terrible problem. Now I look at it as use targeted tools. Use a targeted embargo, and I think for example the free trade zone business, you have to insist that free trade zones document stuff that goes in and stuff that goes out, not just simply let it go in and out.

Mr. ROYCE. As I understand you, in your view if we put the same resources that we do on all of these other fronts into Treasury and so forth in order to target the money laundering and everything else, you think we would be more effective.

Mr. BLUM. I think we would be much more effective because that targeted stuff would get at the very things we really do not want shipped, and it would create certain financial strains in places and ways that work.

Mr. ROYCE. I thought your presentation, your arguments were very interesting. I am not sure that you have convinced me in your written report here on South Africa because I do think that is a case where sanctions actually did bring a regime. I do not dismiss what was done to get around it by Mr. Rich and others.

Mr. BLUM. They actually were on their way to nuclear weapons in the middle of the sanctions.

Mr. ROYCE. Yes.

Mr. BLUM. And the sanctions only worked when the rest of the world finally got on board.

Mr. ROYCE. Yes.

Mr. BLUM. Now that was the turning point, and I just say that you really do need that kind of worldwide revulsion to make things happen.

Mr. ROYCE. Do we organize NGO communities around that? Do you guys help to get that effort?

Mr. BLUM. That is part of what you have to do. The thing that works—I advise banks and brokerage houses on money laundering issues—and the thing that is most convincing to the people I talk to is to point out reputational risk. What would it be like if the general public in the United States found out that wires that were supporting let us say nuclear proliferation in Iran were going through your bank? And the answer is, oh my God, that could be a bet the business proposition. We better make sure our system prevents it. So it really is the public revulsion not only here but abroad that makes it work.

Mr. COMRAS. I would like to make two points if I can. One is oil is a two-edged sword when it comes to Iran. It accounts for 80 percent of Iran's export earnings. Over 50 percent of the government's budget. So Iran is itself a prisoner of its own oil exports, and cannot afford to any great degree to curtail those exports without having major consequences for the Iranian regime and for the public at large.

And second of all, I think one of the problems with Europe is that we have set the bar so low that we have called success when we have not achieved success. And why should the Europeans go beyond what the United States is satisfied with? We have been with satisfied to date with too little, and it is time to raise the bar. Thank you, Mr. Chairman.

Mr. ROYCE. Thank you, sir.

Mr. SHERMAN. Thank you. I think historians will marvel at the enormous cost the United States was willing to pay to deal with the puny nuclear program that Iraq had and our unwillingness to incur any significant costs in order to impose serious sanctions on Iran. I would like to turn first to Mr. Asher and North Korea. The \$25 million as you pointed out is not just \$25 million. But then the question is giving them "back" the \$25 million, giving them back the rest, we gave them back the chicken, are the monkeys still scared?

Put another way, where is North Korea now with regard to its access to banking facilities, particularly in China, compared to where they were before we did the action on the one Macau bank.

Mr. ASHER. It is an excellent question. I think that the monkeys are most definitely still scared, and the private sector has on its own now commenced a series of investigations in working with law enforcement authorities around the world, one of the most important which is having Lloyd's of London, its extraordinary hundreds of millions of dollars in North Korean insurance fraud. They manufactured essentially just like they manufacture counterfeit currencies, a much bigger income earner, essentially pure profit, the Korean National Insurance Company which used to be called the Korean Foreign Insurance Company has taken out reinsurance from—somehow I do not know why—Lloyd's people have bought it

but they have underwritten the reinsurance. They come up with a disaster.

I mean there are disasters in North Korea like the Eungshun explosion or floods but people do not have insurance essentially. They make it up. They provide and they claim reinsurance on insurance people did not have. It is a huge racket.

Mr. SHERMAN. And Lloyd's was——

Mr. ASHER. The thing is——

Mr. SHERMAN. This serves Lloyd's right.

Mr. ASHER [continuing]. It is a major—it is over \$150 million in question in the British courts right now. I think they are going to lose, and that will be——

Mr. SHERMAN. Do you think North Korea will——

Mr. ASHER. So that is the private sector. I think North Korea will clearly——

Mr. SHERMAN. When you say they are going to lose, you mean North Korea will not recover the \$150 million vis-à-vis Lloyd's?

Mr. ASHER. Exactly. They have been doing this for years apparently. They had hundreds of millions of dollars in crop insurance. They did the same thing in 1997 and 1999. They even scuttled apparently one of their ships. They collided deliberately with a Hyundai merchant ship in the middle of the Indian Ocean. They carried \$70 million insurance. Their ship collided with the Hyundai ship. This is right in the run up to the 2000 summit, and the ship even though it had basically a dent on its bow, it just merely sank, which implies it was exploded. They blew it up, and they sank it. A great way to collect insurance.

You know so but the point is the game is up, and I feel looking back at my time in the government, I am glad that we you know spent a lot of time working with law enforcement to uncover these. The thing that is ongoing that really does deserve some attention is the investigations by a whole variety of U.S. law enforcement agencies. I was very involved in instigating them. I did not tell them how to investigate it. They have done great work.

The problem is what do you do with it? You know are we going to indict the North Koreans for what they are doing or not? It was our decision—and I worked for Colin Powell and Rich Armitage—were not against an engagement. We created the Six-Party Talks and participated in them but we felt that the North Koreans know they are doing this stuff, and they should know that there is a price associated with it, and our goal is you know to get them to stop.

One way to do that is to actually bring forward the evidence that has been collected in U.S. law enforcement investigations so the whole world knows that we are not making this kind of stuff up.

Mr. SHERMAN. We certainly have a long way to go if just a few years ago Lloyd's was selling them reinsurance, and I hope we do not have to go to the point of counterfeiting their currency.

Mr. ASHER. Well we would not do that but some people seem to think that we are making this stuff up, and the problem is if they start to believe it, and they see us turning back money that was clearly linked to illicit activity in Macau, they may start letting down their guard because you know especially as I hope they will, the Six-Party Talks start to take off a bit. I do not think the North

Koreans are going to give us anything more than a freeze for compensation personally. That is another topic. But I think that I could draw—

Mr. SHERMAN. I think I need to go on to another witness. Treasurer Steelman, we have talked to other pension plan trustees, private and public sector, and they say, "God Brad, you are right. We ought to divest, but we are going to get sued because we are not maximizing our return." Now you have one possible answer which is hey, you are earning a great return, but you know there is no guarantee that your portfolio is going to outperform others in the next quarter.

Has anybody ever tried to say they are going to sue you for breach of fiduciary duty because you are not earning every last cent that somebody thinks they might be able to earn by investing in terrorism?

Ms. STEELMAN. No one has brought it up except the investment managers, the same people who are bringing it up to you.

Mr. SHERMAN. So you have tens of thousands of beneficiaries of your plan, virtually every State worker in a relatively large State, and not a single one of them has said—

Ms. STEELMAN. Not a single one.

Mr. SHERMAN. Not a single one.

Ms. STEELMAN. In fact, when they find out that their taxpayer funded pension and plus their own contributions from their hard-earned jobs with the State, when they find out about this they are outraged. They do not want their money there.

Mr. SHERMAN. They are outraged that this had not been done earlier.

Ms. STEELMAN. Exactly.

Mr. SHERMAN. And they are happy that you are doing it now. The other argument I am getting from CalPERS is that somehow a huge percentage of their portfolio would have to be sold. What percentage of—I assume you had a diversified portfolio of chiefly U.S. but also international investments—what percentage did you have to sell to get away from investing in terror?

Ms. STEELMAN. Well as I said, we estimated about \$20 million out of a \$6 billion pension fund.

Mr. SHERMAN. \$20 million. And you divested both from U.S. companies and foreign companies that do business with, I believe you identified, four terrorist states?

Ms. STEELMAN. That is right. Of course the domestic companies are prohibited from doing business there.

Mr. SHERMAN. A few do through their subsidiaries.

Ms. STEELMAN. That is true but theoretically it is just international companies but the other argument, and I as a fiduciary have the responsibility of making sure that we do get a good rate of return but that we are also assessing risk, and there is no question that there is risk associated with investing in companies who do business with governments that our State Department and Treasury have deemed economic sanctions and have designated as state sponsors of terrorism, and I am not the only person who thinks this in the world. I mean the SEC has looked at and has inquired of companies if they are disclosing to their shareholders

the fact that they are investing in these kinds of companies who are doing business in those countries.

Mr. SHERMAN. Yes. I would point out that these companies face several types of risk. They face a general representational risk. They face a risk of divestiture by investors, and it is always best to sell your stock a day before everybody else sells theirs. So by acting first, Missouri has protected its employees and its beneficiaries. Finally there is a consumer risk because not everybody in this country owns stock or has control over stock. A lot of people may have a pension that they have no control over, but we are all consumers, and if this or that oil company you know loses even 1 percent of the U.S. market, that could adversely affect them which adversely affects their stock price, which gives investors another reason to sell off, et cetera.

So I wish I could transfer my Federal pension investment into the Missouri fund. Unfortunately, I have not figured out a way to do that. But I think you are protecting your beneficiaries for reputational risk, loss of investment risk and a loss of consumer confidence risk. I kind of cut you off there. I do not know if you have any further comment.

Ms. STEELMAN. Well I would comment to what you just said is one thing that I think Congress could act on is to make sure that the Federal pension funds are not being invested in this way, and the only way maybe to do it you know we did it in Missouri by making that choice. This is not legislation. It is not mandated. We made an investment decision which again I think from a fiduciary responsibility and the question that you originally asked investors make decisions every day about that.

Institutional investors make decisions about what to invest in and why, and so it just seems to me that to begin with that the Federal pension plan should not be investing in our enemies when we are funding military personnel who get retirement from that very same pension plan.

Mr. SHERMAN. Yes, I could not agree with you more. Not only do we invest in such entities, but we force our employees to do that. In other words, we do not give them the choice. We give our employees a choice of four or five different investments, but your stock investment fund has just a little bit of terror in it. Your international stock investment fund a little bit of terror. Your bond investment fund just a little bit of terror. You do not have a choice.

As it happens, Federal employees can invest exclusively in U.S. treasuries, but that certainly is not the investment strategy that is advised, especially for younger employees, but that is the only choice available let alone mandated. I would think that people who draw their paycheck from the Federal Government should be told that they should not have their money invested in terror, or at least their Federal pension should not be, and we ought to be following Missouri. I am going to yield to Mr. Royce for a second round, or I will ask another question or two.

Mr. ROYCE. I am fine, Mr. Chairman.

Mr. SHERMAN. Okay. Well I will try to keep you entertained. Mr. Robinson, you are the holder of the information. You study this. Is this available online, or is this proprietary you have to pay a fee to find out? If I want to buy tennis shoes only from companies that

are not part of a group of corporations, one of which is investing in the Iranian oil fields, can I go to your Web site or do I have to pay you a fee?

Mr. ROBINSON. Well it is a proprietary database in the sense that a lot goes into not only identifying these companies, profiling them, but updating that information quarterly but it is a modestly priced event that would be lost in the noise frankly for any institutional investor, and in the case of retail or average Americans that want to take advantage of terror-free investing.

Fortunately that is now an option that is in effect free of charge on Missouri's 529 plan for example, and we are going to be seeing a number of other terror-free and Iran-free products and services hopefully come to market in part because of events like this hearing today.

Mr. SHERMAN. But if I am a consumer rather than an investor, and I want to know which oil companies I should buy my gasoline from or which banks I should do business with, are you going to help me?

Mr. ROBINSON. Well we are going to try to equip product providers to be able to help you because we will work with them. We just cannot put the data out on the internet so to speak.

Mr. SHERMAN. Because then that—

Mr. ROBINSON. We would be out of business for starts but it would also not be a dynamic picture. Companies are going in and out of these countries all the time. So a photo or a snapshot if you were to get a hard copy of that list right now it could obviously be quite different 3 months from now. So it is a dynamic process, and there is I think a legitimate market involved.

Mr. SHERMAN. I would hope that some retailer with some fortitude, I think is the term I had in mind, would have the guts to subscribe to your service, identify which of their competitors is investing in Iran for example, and then do an ad campaign that says, "We never invested in Iran, we never will, and here are three of our competitors that do. Would you not prefer our product?"

Mr. ROBINSON. It is a differentiator, Mr. Chairman.

Mr. SHERMAN. And certainly they would not have to just be saying it themselves. They could get the Conflict Securities Advisory Group to provide that information. I realize that a lot of folks in the business world do not want to get their knuckles bruised throwing that kind of punch, but the fact is we as consumers want to know.

Mr. ROBINSON. I think that is right.

Mr. SHERMAN. And the best way we are going to find out is through advertising.

Mr. ROBINSON. That is right. And Mr. Chairman, if I can go to just something else you pointed out and that Treasurer Steelman I think answered properly and eloquently is the issue of the fiduciary responsibility and risk here. For example, in Ohio there is a very important debate and even battle looming right now with its Iran divestment legislation which is blanket versus targeted. It is basically saying that any company with active ties to Iran is out of that State's portfolio. It leaves it to the external fund managers to make that happen, and that is what creates new products and services for average Americans to take advantage of.

And then you have folks like the National Foreign Trade Council and other detractors coming in with frankly somewhat scare-mongering tactics that this is going to involve draconian costs. That it is unconstitutional which is a good one because if you think about it, what State does not have certain restrictions in their investment policies? Tobacco. Human rights. Labor rights in the case of California.

Lots of States do this, and the fact is that when you have the SEC talking about the fact that there is an inordinate risk to share value here, how does this kind of decision which as Treasurer Steelman says takes place every day become a constitutional matter? I just do not buy it, and I think that that is why we need to focus greater attention on battlegrounds like Ohio and how this goes there because frankly so goes the nation.

Mr. SHERMAN. Did you say Ohio or Illinois?

Mr. ROBINSON. I am sorry?

Mr. SHERMAN. You said Illinois earlier. Now you are saying Ohio.

Mr. ROBINSON. I am sorry. Illinois did a very powerful model on Sudan. Ohio is the one right now focusing on Iran, and I would merely commend to the committee's attention to take a look at that because it is going to be a pivotal debate where these various detractors and proponents come together and have this out, and in the balance gets to Mr. Royce's issue of what a potent instrument this can be when you empower individual Americans to make this kind of choice.

You talk about reputational risk as Mr. Blum did. This is putting these companies in a stark position where they have to make a choice between their rather limited business interests, in some cases with Iran, versus their standing in the United States capital markets in places like the New York Stock Exchange. Trust me, it is an easy decision for them.

Mr. SHERMAN. Yes. Just a comment on the constitutional argument, and that is whatever the fiduciaries do to protect their investors—and we have just identified three reasons why it is a bad idea to invest in companies that invest in terror—they can do for that reason I think without any constitutional argument. If they are doing it for the purpose of affecting foreign relations—

Mr. ROBINSON. Agreed.

Mr. SHERMAN [continuing]. Somebody could argue that it is unlike tobacco policy, which is an exclusive issue of the Federal Government. That is why I look forward to working with perhaps Mr. Royce and others on legislation that makes it clear that your fiduciary duty argument goes away by Federal statute.

Mr. ROBINSON. Right.

Mr. SHERMAN. And that the Federal Government encourages and authorizes all of its States and cities and other governmental entities to divest, and therefore anything that they do along those lines is not adverse to, or in conflict with, Federal control of foreign policy but in furtherance of it. That should apply not only to investments, but also to those that wish to alter their procurement roles to do business only with companies that do not invest in terror.

Mr. ROBINSON. Exactly.

Mr. SHERMAN. At this point, let me yield to the gentleman from southern California, Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman. I was going to go back to Mr. Blum with a question because in my office Tom Sheehy and I have gone round and round on this question of effectiveness of sanctions, and I know where you are on this, your skepticism of it. But I would just throw out Libya as a question to you. That is commonly held up as an example of the effective use of sanctions that end up stymieing the effort on WMD on all fronts. And I was just going to ask whether or not you concur or if you see that differently.

Mr. BLUM. I do not think it was sanctions alone. Remember how many years we had sanctions and how many years indeed where we had even military action against them, and they kept going doing unacceptable things; bombing airplanes, sponsoring terrorists, hosting training camps. I think what happens is they reach a point where the society as a whole wants to join the international community, and they begin to put enough pressure on the leader or the leader begins to discover—as I think Ghadafi did—that he does not like to be the outlier any more.

Mr. ROYCE. But that does go back to the question of whether sanctions are what put them there. I have wondered.

Mr. BLUM. I do not know.

Mr. ROYCE. I know that the Prime Minister of Italy said he had gotten that information that it was the toppling of the statue of Saddam Hussein that convinced them. If we go back to your argument that it was a change of perspective on the top part of the population in Libya—and I know a lot of Libyans—that is credible to me but what drove them to that, was it the sanctions?

Mr. BLUM. You know I cannot answer that, and I cannot say they always do not work. It is just that I have seen so many cases where they are honored in the breach where the regime builds the weapon even though we have tried to block everything, where the population starves but the guys who are running the country do not, and I look at that and I say, wait a minute. This is not necessarily the best approach.

It does not mean that it is not a tool, and it can at times be useful, very useful diplomatic tool but no one should think that it is the be all and end all. Now, I think that if you are going to go in that direction, what we really have to focus on are the enabling countries that help people beat the system. You know if you want to have a sanctions regime, put Liechtenstein out of business.

Mr. ROYCE. Yes, that is an area where I think you are absolutely right because access to the international financial system is what every one of these regimes really covets and probably could not function long without, and the question I would just close with, Mr. Chairman, is if we could find an effective way to bring that concerted effort on the Cayman Islands, at Liechtenstein and so forth, and your free port argument that you made in your testimony.

Mr. BLUM. The Iranians have a free port Kish in the Persian Gulf, and the Iranians use that as a center for getting dollars from Russian gangsters. It is a center for smuggling. It is a center for arms trans-shipment. They have regular commerce with Dubai, and Dubai has become the financial center for all of the stuff that is going on with Iran. Dubai has no controls. It has a free port that

is absolutely wide open, and it is where Halliburton moved when we began talking about putting pressure on the oil supply business.

There are some things here that we have to do in conjunction with the discussion of sanctions, and I think that those things are pretty high priority.

Mr. ROYCE. Well, Mr. Chairman, thank you. Panel, thank you.

Mr. SHERMAN. I will just point out one thing about which sanctions work and which do not. Libya and South Africa had one thing in common and that is it was not just the United States, and the sanctions that have not worked have tended to involve only the U.S. This turns our attention to how do we get Europe on board, or better yet, the U.N. on board. Now, if we get the U.N. sanction, that is probably the best way to convince Europe to join us, and we then get at least some hope that Russia and China would actually adhere to a well drafted U.N. resolution. It is just up until now they have not allowed one to be adopted, given that they have a veto, et cetera.

So the question for Mr. Comras is: How do we get Russia and China, assuming this is our number one priority, assuming that we are willing to use every lever we have with Beijing and Moscow, how do we get Russia and China to allow us to pass meaningful sanctions at the U.N. rather than the no Disneyland for Revolutionary Guards sanction that we have now?

Mr. COMRAS. I think the road starts with Europe again. First we need to get the Europeans to take a much stronger position vis-à-vis Iran, and once they buy into a common position with the United States on stringent, targeted sanctions that have an impact and that make sense, I think that they alone can carry the day without Russia and China. But, I believe also that by doing so will bring Russia and China into that same approach.

Mr. SHERMAN. Why do you think Russia and China would change their behavior vis-à-vis Iran just because Europe was kind of cajoled, kicking and screaming, but finally agreeing to sanctions? Just because Germany will not invest in Iranian oil fields, why would China not?

Mr. COMRAS. Well I start with the proposition that even without China and Russia, if the Europeans take the appropriate measures they will put pressure on segments within the Iranian society to begin to force a rethink on the policies adopted by Iran. And, once you have begun that process then Russia and China have everything to gain by joining in and continuing that pressure. The most important factor in sanctions against Iran will be that China and Russia not step in to take the place of Europe.

Mr. SHERMAN. Right.

Mr. COMRAS. But that will be a time consuming event in any event. Russia and China are not in a position to take over the balance of trade which involves almost 40 percent of all of the non oil—40 percent even including the oil trade—but 40 percent of the commerce of Iran is with the European countries not with Russia and China. In that trade, Europe enjoys a trade balance. That is, it sells more to Iran than it imports from Iran, even counting the oil.

There would be such a dislocation within the commercial class particularly in Tehran if the European began to tighten up on that

trade and began to restrict it, that that would have major implications now for putting pressure on Iran to comply.

Mr. SHERMAN. Thank you for your comment. I sense Mr. Blum wants to make a very, very short statement.

Mr. BLUM. I have one very brief thing I would like to tell you about which is last fall I was asked by a subcontractor for the State Department to prepare a module on controlling the monetary aspects of weapons of mass destruction that they were going to use in a worldwide education and awareness program in connection with the U.N. This had come through a prime contractor, a subcontractor, and suddenly for reasons I cannot even comprehend and which in conversation I learned senior people of the State Department were unaware, the module was pulled and the program was canceled.

I have to tell you that when I look at the way this stuff is contracted out, subcontracted out, and then mismanaged, I think there is a little bit of oversight work to be done.

Mr. SHERMAN. Well, we look forward to that responsibility as well. Finally, I would say that sanctions on Iran which has been a focus for us, it is not a matter of the effect they have on the Iranian economy. I mean I wish prosperity for all of Iran's people. It is the effect they have on the politics of Iran. For that to happen, we have to be able to broadcast in Iran a single message, and that is "your country is going to do much worse if you continue your nuclear program, and it is going to do much better if you abandon it and join the world nations."

I would like to start those broadcasts now. Unfortunately, I do not lie that effectively in Farsi. First we have to make it true, and then we have to broadcast it, and unless we do both, unless we have the political effect, we are not going to change reigning government's policies. I want to thank Mr. Royce for being so patient. I want to thank the witnesses for being here and being patient as well. Thank you very much.

[Whereupon, at 6:40 p.m., the subcommittees were adjourned.]

