

TREASURY’S WAR: THE UNLEASHING OF A NEW ERA OF FINANCIAL WARFARE

Juan C. Zarate

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Have you ever wondered how the United States and other countries actually conduct “financial warfare”?

Juan Zarate, who served as assistant secretary of the Treasury for terrorist financing and financial crimes and was on the staff of the National Security Council, describes many of the weapons of financial warfare and their actual use in “Treasury’s War.” Countries have used blockades, trade embargoes and sanctions, and even freezing assets, as ways of putting pressure of their enemies for centuries.

What is new is the systematic squeezing of the financial systems of countries, including Iran and North Korea, and non-state players like Al Qaeda. Zarate defines financial warfare as the “use of financial tools, pressure, and market forces to leverage the banking sector, private-sector interests, and foreign partners in order to isolate rogue actors and commercial systems and eliminate their funding sources.”

Terrorists and other bad actors not only need money but they need to transmit it to others. In order to be able to see such transfers, governments have greatly expanded anti-money-laundering regulations,

requirements for financial transparency and information sharing. These regulations not only cover banks but also other financial institutions, such as insurance companies, brokers and dealers in precious metals and stones, and money transfer businesses, including hawaladars.

The idea is to make it too costly through regulatory penalties for these businesses to deal with the bad actors. As Zarate notes: “We realized that private-sector actors – most importantly, the banks – could drive the isolation of rogue entities more effectively than governments – based principally on their own interests and desires to avoid unnecessary business and reputational risks.”

At Treasury, there is a section, the Office of Foreign Assets Control (OFAC), that is responsible for all U.S. sanctions programs and has the ability to target and sanction violators with asset freezes and fines. The U.S. dollar is the benchmark for most international trade, and thus banks throughout the world must keep corresponding bank accounts directly or indirectly for dollar clearing. Ultimately most transactions pass through a bank account in New York. Compliance officers in the big banks and law firms find it very costly to attempt to defy OFAC regulations seeking to identify suspicious transactions. No bank wants to be labeled as a terrorist or drug dealer enabler.

After 9/11, Congress passed the Patriot Act which greatly expanded the anti-money-laundering powers of the federal government. Much of “Treasury’s War” is an explanation of how Treasury used its various powers over financial institutions in specific cases to hobble or eliminate the ability of bad actors to transfer money or otherwise use financial assets.

Not all countries have been happy with the way the Treasury has used its power. One example – the U.S. shut down the Al Barakaat “international remittance system founded in Somalia in 1986 to allow Somali expatriates to send remittances to their homeland, a nation with no formal banking system and a nonexistent governance structure. Al Barakaat eventually grew into a large international network of remitters, money-service businesses, and hawaladers in more than forty countries, including the United States and several European countries. Millions of dollars were coursing through Al Barakaat’s network every year – mostly from innocent Somali expatriates in Somalia”.

U.S. intelligence found that the network was controlled by an individual who had sent some of the proceeds to Osama bin Laden and Al Qaeda, but “most of those remitting money had no idea this was happening” and were innocent of connections to Al Qaeda. Even so, Treasury took down the

entire network on November 7, 2001, which upset a number of European countries because of the noncriminal standard of evidence that Treasury had employed in its actions.

Section 311 of the Patriot Act that Congress passed in October 2001 gave the Treasury Secretary, “the ability to designate foreign jurisdiction, institutions, types of accounts, and classes of transaction as ‘primary money-laundering concerns.’ The Treasury was empowered to impose countermeasures against these primary money-laundering concerns and to compel U.S. financial institutions to take certain specified steps to guard against the possibility of facilitating the financial activity of designated entities.”

The steps included closure of accounts, which could be fatal because all banks need corresponding banking relationships. Banks suspected of aiding terrorists, common criminals, tax evaders, etc., or having insufficient ‘know your customer’ and other controls, were labeled ‘bad banks.’ Once labeled a bad bank, other banks and financial institutions would quickly cease dealing with them because of their own reputational risk.

The Patriot Act gives the Treasury Secretary and other government officials enormous power over the financial industry (very broadly defined) which can be and has been abused. The government can essentially label any domestic or foreign institution as a ‘bad bank,’ merely on suspicion rather than an objective standard of real wrong doing.

The anti-money-laundering statutes are broadly drawn and lack sufficient specificity because money laundering is often viewed as crime of intent rather than a specific action. Zapate, in his zeal to trumpet his and the government’s successes in bringing down institutions, appears all too insensitive to the rights of the innocent and falsely accused.

Another example, one of Washington’s oldest and highly regarded banks was the Riggs bank. It had developed a strong business in serving embassies, foreign governments and diplomats. Regulators alleged that Riggs had maintained inadequate controls on high-risk accounts and failed to detect and report suspicious activities by certain governments. The government levied a \$25 million dollar fine on Riggs, which had approximately \$5.8 billion in assets at the time. The government accusations destroyed Riggs’ reputation and caused a flight of accounts forcing the bank to sell its operations and go out of business.

The 'Bad Bank Initiative' was not only launched against institutions but also against jurisdictions, including Ukraine and Nauru. Banks in Burma (Myanmar) were targeted for alleged drug trafficking. Syrian banks were targeted for money laundering, sanctions evasion and terrorist financing. Banks in Northern Cyprus and Belarus were labeled as bad banks for a variety of offenses, and on and on.

In the government's never-ending efforts to target global wrong-doers, including those who deal in stolen assets, more power was given to both Treasury and Homeland Security. In December 2004, Congress created the Office of Intelligence and Analysis, making the U.S. Treasury Department "the first finance ministry in the world to have an arm with an active intelligence unit."

This unit quickly became active in identifying those institutions and individuals who facilitated nuclear "proliferation financing," including those who aided the A. Q. Khan's operation out of Pakistan. Officials were able to identify and disable groups that facilitated North Korea's financial operations, including banks in Macau. Distribution of counterfeit U.S. bank notes printed by the North Korean government has become more difficult for them as a result of U.S. actions.

Treasury's War is perhaps the most detailed account to date of the various actions the U.S. government is taking to disrupt terrorist and criminal financial activities on a global basis. Many bad actors have been eliminated or disrupted by the aggressive action of those fighting on the financial front. The problem is the U.S. unilaterally has given itself the authority and the tools to act as the global financial cop. It is one thing to attack terrorist financial networks, but it is another to attack foreign banks and other foreign financial institutions because their tax and privacy laws are different from those in the U.S., which has occurred in a number of cases.

As Lord Acton warned us, power corrupts and is often abused. There are few restraints on what those in government are now allowed to do in fighting money laundering in its broadest sense. Institutions and individual reputations are destroyed without having gone before a judge or jury or having been convicted of anything. Bureaucrats in the U.S. government can use their own judgment to decide what is a 'bad bank,' and the mere accusation can destroy it.

This is dangerous territory, not only for protection of civil liberties, but adds to the fragility of the dollar-based global financial system. The incentives are very strong for both honest and dishonest players in global finance to find ways of avoiding the use of the U.S. dollar and the disproportionate

power it gives the U.S. over their institutions and actions. The U.S. may be winning the game at the moment, but the arrogance and ultimately the abuse of power that will also certainly occur by government officials who operate with little restraint is something we may all regret.

Juan Zapate and his colleagues in the Bush and Obama Administrations probably were operating from high motives, but Zapate's own detailed descriptions of the bureaucratic infighting should give pause about the power that he and his colleagues had and have. Zapate spends far too much time in settling scores and detailing both the appearances and personal quirks of both friend and foe, as Washington officials are prone to do in their books. He gives us more details of meetings than we need to know, perhaps to let the reader know he was a "player."

That said, the book does provide a real public service, perhaps in ways that Zapate did not fully anticipate. By describing in detail how the U.S. conducts financial warfare and the enormous power the government has to do so, Treasury's War might help provoke a healthy debate on what the appropriate checks should be.

