

The dynamically evolving Terrorism Finance System

Executive Summary

- Counter terrorism financing has emerged as one of the main strategies to combat terrorism in the past decade. The notion that depriving insurgents of all funds could curb terrorism resonated in speeches by policy makers worldwide in the past decade. Numerous Anti money laundering laws, compliance and regulatory requirements and accountability initiatives have done much in the post 9/11 scenario to stem terrorist attacks.
- There have been arguments proposing that terrorism, as most asymmetric warfare goes, is a cheap enterprise, and is therefore, unaffected by financial oversight which cannot trace amounts as small as those required in staging attacks. However, the terrorism financing machinery involves many costs that support terrorist organizations that ultimately stage attacks. The questions as to whether those finances can be traced and curbed remains to be answered.
- Tighter financial scrutiny has seen the way terrorism financing machinery respond in various ways. The system has become more fragmented, and terrorists are constantly relying on locally funded units to fund and support their activities while they operate globally, now more than ever. Tighter financial scrutiny has also seen various substitution effects; terrorist organizations are now avoiding the formal banking system and using parallel channels that are far more difficult to monitor. Various mergers of the crime nexus, where terrorists are increasingly resorting to the channels used by for-profit crimes have also been observed.
- As the terrorism financing methodology evolves, policy makers would have to develop a more comprehensive approach to combat the more evolved and fragmented system. At the same time, overregulation has caused significant reduction in efficiency of financial institutions worldwide. The past ten years have revealed that there is a need for better targeted compliance policy.

Introduction

Terrorism financing had been on the fringes of counter-terrorism strategy and garnered much attention and became one of the key areas of counter terrorism strategy over the last decade. The idea that terrorists could be shut down by being starved of their funds gained momentum after the 9/11 attacks and after American and European authorities began cracking down on possible sources of terrorism funding, both domestically and internationally. But over the years, the 'terrorism financing machinery' has proved to be a dynamic enterprise, evolving constantly, being thwarted repeatedly by the vigilance net set up by western nations, but adapting newer ways to continue functioning. Tracking terrorism funds has proved to be an elusive enterprise with funding sources constantly changing, with the advent of cheap, localized, self-sustained terrorism groups working across geographies, and with international co-operation across political borders often proving to be a challenge. In this dynamically evolving scenario of terrorism financing, does the strategy of countering terrorism by stymieing funding by imposing enhanced compliance and regulatory requirements make any economic sense? Is it counter terrorism financing still a feasible strategy? This paper attempts to answer some of these questions and to look at how terrorism financing has evolved in response to the financial dragnet set up by western nations.



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Counter Terrorism Financing alongside money laundering has become a keystone of counter-terrorism policy in the past decade.

The beginning of modern counter terrorism financing

'If Fanaticism is the heart of modern terrorism, then finance is its lifeblood.' This declaration by British chancellor Gordon Brown in 2002 seemed to highlight a key strategy employed by governments worldwide post 9/11. Among many circles, there also seemed to exist the notion of a systematic *terrorism financing system*, a machinery of sorts, that can be attacked and systematically dismantled, therefore theoretically stemming all terrorist activities. Efforts to tackle this machinery have shown results in curbing a plethora of incidents, but authorities have seen the system adapt to one that renders detection and prevention extremely difficult. One of the first obstacles encountered, was that terrorism, as the epitome of asymmetric conflict, could be very inexpensive, and grew ever so more so over the last decade.

The notion of cheap terrorism

Table 1 lists some prominent terrorist attacks in the 2000s, and the estimated costs of these attacks. Apart from the 9/11 attacks, all of these attacks have been estimated to cost less than 50,000 USD. This is often the case in asymmetric conflict when results weighed economically far outweigh the costs involved. (Even in the case of the 9/11 attacks, the economic costs of the outcome have been measured to be about \$3.3 trillion^[1], not considering losses in financial markets worldwide. This figure dwarfs the cost of half a million dollars involved in staging the attack.)

Cheaper attacks imply smaller money flows. Smaller amounts make it far more difficult to trace transactions and to effectively use a 'compliance net' in order to curb terrorism funding. Many banks across the world monitor transactions over certain amounts (US banks file a CTR for transactions over \$10,000) but if the costs involved in these attacks are relatively small, there is very little that banks can do without overburdening their operations with monitoring costs that would make little economic sense.

Another argument proposed over the past few years (examples) has been that the estimates of these terrorist strikes only deal with 'direct costs'. For example, the estimated 9/11 costs take into account flights bookings, hotel bookings, daily expenditures, weapons used in the attack and operational costs linked directly to the event. However, these attributed costs have been stated to be gross oversimplifications and have been criticized for not truly reflecting the money trail that terrorism leaves behind.

maintenance of sleeper cells, compensation paid to families of suicide bombers and a vast array of 'indirect costs' that make the fostering of terrorists, and the final terror strike possible. These attacks would bloat the 50,000 USD figure, and make it far larger, and make it something that can no longer be swept under the carpet. The indirect costs, together with their direct counterparts comprise the true 'terrorism financing system'.

Table 1: Estimated Cost of Attacks

Year	Location	Estimated Cost of Attack
2001	New York, Washington	\$ 300,000 - \$ 500,000 ^[2]
2003	Istanbul	\$ 40,000 ^[3]
2003	Jakarta	\$ 30,000 ^[3]
2004	Madrid	\$ 10,000 ^[3]
2005	London	\$ 8,000 ^[4]
2008	Istanbul	\$ 10,000 ^[5]
2011	Oslo	\$ 20,000 ^[5]

The argument that these direct costs are not the sole costs responsible in financing these attacks proceeds as follows:

Claiming that these attacks cost only 50,000 USD, is akin to saying that a shirt only costs \$20. A particular shirt in a store could be retailing for \$20, but if an ordinary citizen were to be given \$20, could he or she possibly replicate the shirt from scratch with just \$20? Cotton-picking, factories, designing, supply-chain logistics, worker's wages, profit margins, salaries of hundreds of personnel, etc., are the infrastructure that make it possible for the shirt to finally retail at outlets available to an end consumer. Similarly, the infrastructure that lies behind a terrorist, who in this analogy is comparable as a skilled end-product, comprises of training camps, housing, food, support, weapons, intelligence gathering, forged identity and travel documents,

These indirect costs do present another avenue for curbing the financing of terrorism. However, the notion of indirect costs being a truer reflection of terrorism financing is of use to this discussion only if these money trails can eventually be monitored and used to stem terrorism funding, which has often proved to not be the case.

The traditional terrorism financing system

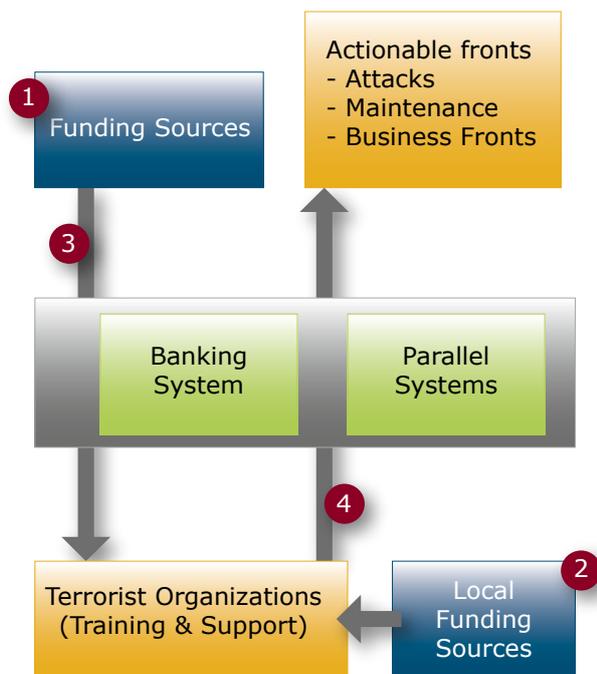
The more traditional model of terrorism financing is represented in the figure 1.

Trying to tackle the infrastructure of terrorism financing has seen authorities focusing their efforts on attacking the sources as well as the channels of these finances.

Funding sources across the world have included wealthy individual sponsors, charitable

organizations, and legitimate as well as illegitimate businesses or business fronts. Local funding sources (which traditionally lie outside the sphere of the western banking system) include more of the same and other sources such as the sale of illegal drugs, criminal activities, ransom money from kidnapping and alleged state sponsorship. '1' and '2' represent the source-points wherein these funds are accumulated and the efforts of authorities to preclude these sources. ('2' represents the accumulation of these funds in geographies that are local to indirect cost activities, and lie outside the sphere of the formal banking system).

Figure 1: Traditional Terrorism Financing System



Moving on to the channeling stage, funds once gathered despite the efforts at '1', are transferred to terrorist organizations, either through western banking systems or through parallel systems wherein the funds can then be used either for attacks, for maintenance and support, or simply to set up new business fronts. '3' represents the channeling of these funds to different areas that support the indirect costs of terrorist organizations spoken of earlier. '4' represents the efforts of these organizations (or their new sources) to chan-

nel the money back. The efforts to preclude the channeling of funds at stages '3' and '4' through the banking system overlap significantly with cases of money laundering (and in fact, terrorism financing can be taken as just one example of money laundering) and sees action in the form of monitoring of suspicious transactions and bank accounts being frozen. This is also the area that has seen significant increases in costs owing to additional monitoring and compliance norms adopted by the banking system in the past decade. Increased due diligence costs have overburdened many financial institutions (although, arguably, have set up a massive new industry with many new jobs that aim at achieving compliance).

The role of Offshore Financial Centres, and more specifically, of 'special jurisdictional enclaves that offer financial services by removal of some or all state regulation'^[6] came under scrutiny after 9/11 (and more so after high-profile cases of their use in tax evasion and money laundering came to light in the public media). These economies ranged from offshore island enclaves such as the Cayman and the British Virgin Islands to the banking system of Switzerland. They offer financial services 'to nonresidents on a scale that is incommensurate with the size and the financing of [their] domestic economies,'^[7] were pressurized increasingly by governments across the world to introduce more transparency and accountability in their systems. Pressure from the OECD (in the form of blacklisting OFC nations) has led to stricter compliance norms and many 'Know Your Customer' initiatives leading to increased costs that have decreased overall revenues for many OFC nations whilst leading to others to almost completely shut down.^[8] However, it has been observed that thriving finance fronts in the US (Wyoming, Delaware, Nevada) and UK, continue to offer the anonymity that many of the island OFC nations were blacklisted for a decade ago.^[9]

Parallel systems comprise the audit-trail-less 'hawalla' system that gained notoriety after 9/11^[10] came under increased observance

resulting in many of these informal systems being closed. The use of couriers carrying cash stuffed in bags across borders has therefore increased after the financial system came under increased scrutiny.

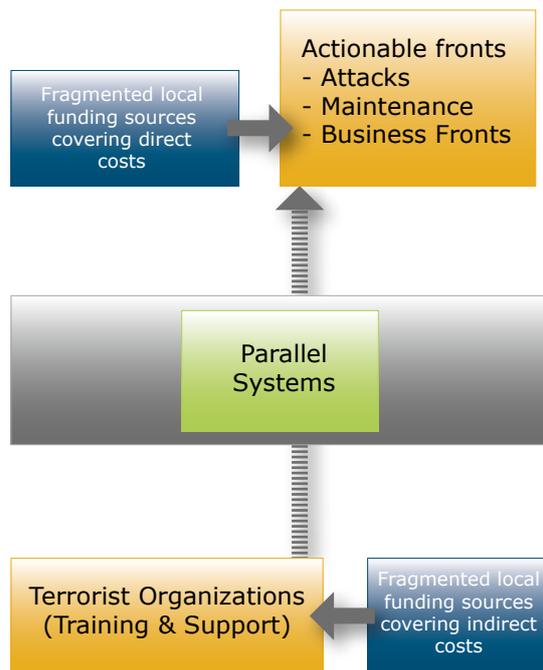
Evolution of the terrorism financing system

In 1996, a group of young Lebanese men were convicted in North Carolina for channeling funds to the Hezbollah. These men used the 70¢ state tax difference levied on cigarette boxes between North Carolina and Michigan to garner \$7.9m over 1.5 years. Investigations after 9/11 found that various charities and wealthy individuals were transferring large sums of money either to directly fund, or to support terrorist organizations. The channels being used by these sources in western countries were either the banking system, or other parallel systems. The 'terrorism finance machinery', as shown in the earlier figure, seemed to rely on wealth gathered and channeled through western systems to train, support and finance attacks.

But increased compliance has seen a shift and various substitution effects in the 'terrorism finance machinery'. Arguably, increased regulation has made it more difficult for terrorism funding using the formal banking system leading terrorists to resort to newer and inventive means to evade the financial drag-net set up by American and European countries. Figure 2 represents a newer and more fragmented system of terrorism financing.

Since 9/11, it has been observed that many organizations such as al-Qaeda have increasingly turned to local cells that run extremely low-cost operations and generate cash through criminal scams and illicit activities. Investigations into several plots in Europe have shown that operatives were often flush with cash, raising far more than necessary through common criminal rackets such as drug dealing and credit card theft. Increased AML efforts have led the amount of terrorism money that passes through the formal banking system to be reduced to a trickle, but

Figure 2: Evolved Terrorism Financing System



has seen increases in couriers that carry physical cash across national borders.

While in the 1990s, funds were being accumulated and gathered in western nations, and then being channeled back to areas that supported terrorist training, it has now been observed that areas that were considered safe-havens for terrorists by Western nations have become increasingly self-dependent. Even local sources that traditionally lay outside the western banking system, have seen a shift in response to increased pressure from OECD nations. These local sources are now far more fragmented; private sponsorship has given way to illegal rackets and business fronts that operate locally, making these organizations increasingly self-reliant.

The push-and-pull game between terrorists and authorities has seen the evolution of a more globalized global-local system. Rather than rely on western sources for funds, terrorists have increasingly turned to local sources to fund training and support. Terrorists once trained in different geographies across the world move to the intended sites of attack and then use local sources there (which have been observed to be illegal smuggling,



kidnapping, extortion, credit card theft, or legitimate business fronts) to maintain themselves and fund their attacks. Terrorist organizations have global outreach but terrorism funding has seen a decentralization of sorts; the concept of a war-chest of fortune stored in bank accounts that needed to be channeled through the financial system for use, has been replaced by a more '*fund-yourself-locally*' but '*be-available-globally*' approach.

The terrorism financial system has now evolved into smaller more discrete units that are not only locally-funded self-sustained standalones (and handle both the '*direct*' and '*indirect*' costs in their own respective geographies) but rely increasingly on local co-operation, particularly with the crime network. The system of terrorism financing is now far more fragmented, and is evolving to one that can entirely bypass the financial dragnet, making prevention of terrorist attacks through curbing terrorism funding even more difficult. Cheaper ways to finance attacks, as discussed in the previous sections, have contributed to the issue.

COUNTER TERRORISM EFFORTS NEED TO BE REVISED AS THE TERRORISM FINANCING SYSTEM EVOLVES

Where do we go from here?

The terrorism financing system is a dynamic one, and one that is ever evolving. Increased fragmentation on the funding side has made it clear that authorities in pursuit of terrorists need to grow and evolve with them. Much of the reaction by authorities in this scenario has been reaction-based resulting in overarching blanket policies affecting too many innocent bystanders.

Increased vigilance in the financial system has led to various substitution effects in the way terrorism funded, and many of these involve local-level activities which are illegal, and harm domestic economies. The aggregation

of these activities, although creating fragmentation in the global terrorist-finance machinery, has led to a local level syndication of terrorism with the crime nexus. Areas such as money laundering and tax evasion had already been tied to terrorism, but areas such as narco-terrorism, identity theft, credit card and insurance fraud, the use of conflict diamonds, piracy money, etc. have offered more scope for co-operation across different branches of finance to consider an approach that is more holistic and at the same time, more watertight with the inclusion of '*indirect costs*' into the terrorism funding scenario. Co-operation across geographies and political borders then becomes key making it essential for counter terrorism financing to be more firmly rooted within counter terrorism policies.

Although fighting the war against terror by counter-terrorist financing will always remain a critical front, it's effectiveness has been undermined in the last ten years with various substitution effects seen in the methods used in raising and transferring money. This prevents the obvious dilemma of Terrorism funding constantly being driven away from the formal banking system, and into areas wherein it escapes scrutiny. The need for then developing expertise and building networks to monitor parallel systems becomes obvious. But at the same time, understanding the limitations of the current scenario would help prevent many financial institutions from losing speed and efficiency, and from possibly, in extreme cases, buckling under the weight of increased compliance costs. More studies need to be conducted which consider economic consideration of regulatory policies and then reconsideration of many blanket policies that affect far too many actors without touching pertinent targets, might be the need of the hour.

In conclusion, there is a need for efforts of counter terrorism financing efforts to be commensurate with the probability of success to make economic sense. Although counter terrorism financing remains one of the cornerstones of counter terrorism strategy, there is a need for it to evolve as the funding system does.

List of Footnotes

1. New York Times, 2011
2. Kiser, 2005
3. UN, 2004
4. UKHO, 2006
5. Brzoska, 2011
6. Palan, 2003
7. IMF, 2007
8. Sharman and Mistry 2008
9. Findley, Nielson, Sharman, 2012
10. Marieke de Goede, 2003

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