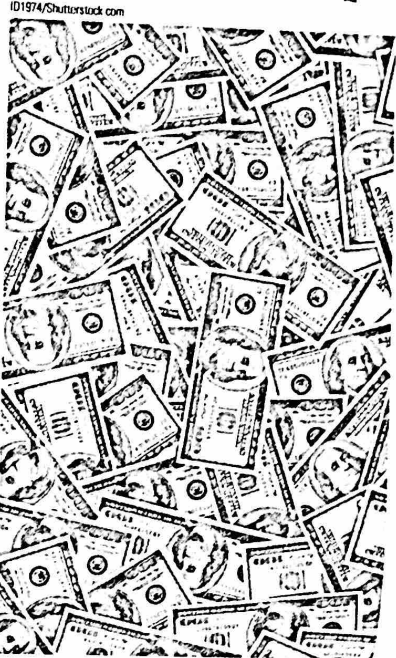


Terrorist Financing and Money Laundering

LEARNING OBJECTIVES

After reading this chapter, you should be able to:

- ▶ Define money laundering.
- ▶ Define terrorist financing.
- ▶ Compare terrorist financing and money laundering.
- ▶ Describe national and international efforts to control terrorist financing.
- ▶ Outline financial intelligence gathering and investigative efforts.
- ▶ Summarize illegal and legal methods of terrorist funding.
- ▶ Describe networks and systems in informal economies.
- ▶ Describe the Hawala system.
- ▶ Summarize views on the political economy of terrorism.
- ▶ Summarize the debate about narcoterrorism.



The New U.S. \$100 Bill

The Islamic State of Iraq and al Sharn (ISIS), also known as the Islamic State, the Islamic State of Iraq and the Levant (ISIL), or Daesh, emerged from al Qaeda in Iraq. In June 2014 in the midst of the Syrian civil war and the sectarian violence in Iraq, ISIS laid claim to territory and acted as if it were a nation-state. It was a different type of terrorist group and financed itself in an unusual manner. ISIS was large enough to take and hold geographical areas, including oil fields and economic centers in Iraq and Syria. This ability placed ISIS in the unique position of raising money by special "taxes" on people in conquered territory, taking possession of wealth by force, kidnapping for ransom, and most importantly, selling oil in an underground economy. According to ABC News (2014), ISIS made \$3 million a day in the summer of 2014, making it the most well-funded terrorist group in history.

All terrorists need money, and as a group's size and complexity increases, its need for income also grows. Large terrorist groups pay salaries to individual members and meet living expense for their leaders. Some groups even pay pensions to former members. Groups raise money in numerous

legal and often illegal ways. They run legitimate businesses, raise money through crime, accept donations, and engage in many other economic activities. This chapter will focus on the methods terrorists use to raise money, their participation in formal and informal financial systems, measures to stop terrorist financing, attempts to investigate groups and individuals, the structure of terrorist economic networks, and a debate about the existence of narcoterrorism.

Financial Flows

When modern terrorism began to emerge after World War II, security forces frequently concentrated on investigative measures, law enforcement, and military force, to counter it. Counterterrorists emphasized tactical control of areas where terrorists operated, and financing was frequently overlooked or ignored. This approach changed by the 1980s as security forces came to realize the crucial role that money played in terrorist operations. In Northern Ireland, for example, law enforcement officials and terrorism analysts realized that the IRA had made a Capone discovery; that is, it developed an organized crime network to finance its operations (Adams, 1986). A decade later, American analysts demonstrated that Middle Eastern terrorists were raising funds in the United States through grocery coupon fraud (Kushner and Jacobson, 1998). Other investigators found legal businesses laundering millions of dollars for terrorist organizations (Navias, 2002). Many terrorist organizations used petty crime, money laundering, and the transfer of illegal contraband to finance operations (Himmet, 2004).

Awareness of the importance of financing evolved slowly, partly because of the inherent contradiction in the cost of a single terrorist event when compared to the cost of a campaign. Stated simply, a terrorist operation usually does not cost a lot of money, but the overall budget for a campaign is quite high. The *Economist* (2003) reports that terrorism is cost-effective in terms of the casualties and destruction terrorist events cause. Events like the 1995 Oklahoma City bombing or the multiple bombing attacks on trains in Madrid in 2004 cost only a few thousand dollars. A single attack like the 2009 Fort Hood shootings might only cost a few hundred dollars. Yet, as Neil Livingstone and David Halvey (1986) explain, it takes a lot of cash to run a terrorist group for any length of time. For example, 9/11 was expensive, but holding al Qaeda together cost several thousand dollars per month (L. Wright, 2006, pp. 168–169). After 9/11, some analysts saw the importance of terrorist financing. They began research projects on fund-raising, money laundering, and the storage and transfer of funds (Jacobson and Levit, 2009).

Money Laundering

It is popularly believed that the term *money laundering* first appeared in the 1920s. It is popularly believed that the term *money laundering* first appeared in the 1920s. Organized crime families earned money through prostitution, distribution of illegal goods, robberies, burglaries, and other illegal activities. While this gave gangsters an abundant income, it also created a problem. They had to account for their assets without linking the source of the money to the crimes they committed. They wanted to move money from the informal underground economy where it could not be used to the formal economic system where they could spend it. They had to make their incomes appear to be legitimate. Organized criminal syndicates opened laundromats, funneled illegal money through them, and reported tremendous incomes. Illegal gains were transferred into legal profits, and both law enforcement agencies and the Mafia

Capone discovery: A term used by James Adams to explain the Irish Republican Army's entry into organized crime.

called the process money laundering (Durrieu, 2013, p. 13). Both sides knew that these businesses probably could not make such profits, but forged business accounting records showed the money was “clean.” It could be used in the legitimate economy.

Roberio Durrieu (2013, p. 19) explains the process. Assume that three criminals make \$3 million by smuggling drugs, and they divide it equally. When they do work, the odd jobs they perform pay far less than \$1 million per year. They obviously want to enjoy it, but when the money is used in the legitimate economy, it becomes part of formal record keeping systems. Banks report large deposits, real estate transfers create multiple financial documents, and other transactions are taxed. The criminals know that any sudden change in lifestyle might bring attention from law enforcement. They may even know that when Al Capone was finally convicted, he was charged with income tax evasion.

The three criminals need to launder the money; that is, they need to give the illusion that their sudden increased income was derived legally. They must conceal the process by which they gained the money to enjoy the fruits of their illegal labor. Laundering allows them to do this.

Money is laundered in three steps. Placement involves putting criminal proceeds in the legitimate financial system. Placement can take place in a single action, such as showing the monetary gains as profits, or it may be laundered through repeated transactions to conceal its origins. This second process is called layering. The final step is integration. This involves assimilating illegally obtained money in the formal economy and giving funds the appearance of legitimacy (Totfängsaz, 2015).

It is hard to trace some money because it is hidden in underground networks or in informal transfers. The U.S. Department of the Treasury (2015) explains that organized crime and drug networks use extensive money laundering systems. Criminal groups will launder money several times, converting illegal income to another form of funds and often further laundering it by other means.

Empirical research shows that terrorists do not usually engage in complicated laundering systems. While terrorists use the same networks and channels as organized criminals, they usually layer illegal money in one step, such as converting cash into a money order, buying prepaid charge cards, or wiring cash to a group’s financier. Terrorists also launder significantly less cash than organized crime or drug networks. One empirical study involving almost 200 money laundering techniques indicated that the maximum sum of money for organized criminals was \$69 million, while the maximum amount for the terrorist cases involved \$4.8 million.

One common method for laundering drug money from Colombia is known as the black market peso exchange. Terrorists, especially the Revolutionary Armed Forces of Colombia (FARC), have used this network, although not as much as drug dealers. In the peso exchange, drug dealers sell their products in the United States and accumulate large amounts of U.S. currency. Unlike in terrorism investigations, law enforcement officers are well versed in disrupting drug networks simply by following the path of such money. As a result, the dealers need to find a way to hide the cash. They do so by selling the money to brokers in Colombia, who pay the dealers in Colombian pesos. This creates no financial record in the United States. Brokers purchase goods in the United States and smuggle them to importers in Colombia. These goods are marketed and sold in Colombia and in other countries at greatly inflated prices. The importers make



FIGURE 3.1 The Process of Money Laundering

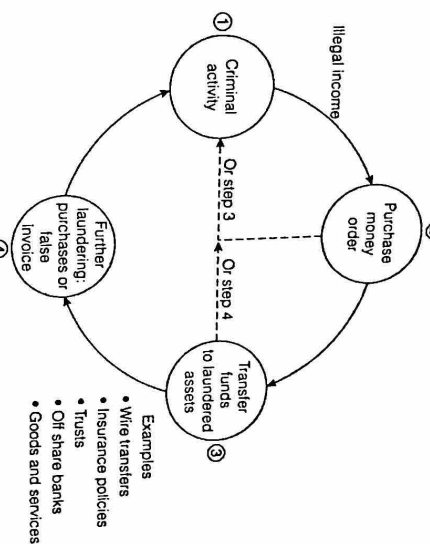


FIGURE 3.2 Money Laundering — Hidden Layers

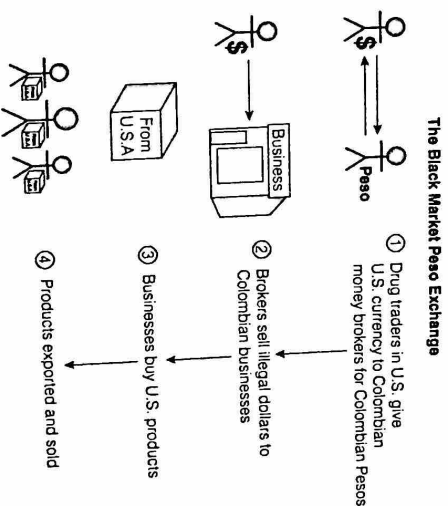


FIGURE 3.3 The Black Market Peso Exchange

a profit, pay the excess pesos to the broker, and the broker, after taking a commission, sends the money to drug dealers in the United States. Dealers convert seemingly legitimate pesos into dollars, and all the money looks legitimate (Zill and Bergman, 2014). A variation of the peso exchange involves selling goods or services at inflated prices. For example, recall the three hypothetical drug dealers who are trying to

account for a sudden influx of \$1 million each. One of the subjects can "sell" his car worth \$15,000 to his colleague for \$30,000. After exchanging several more overpriced goods and producing bills of sale, the money begins to take on the appearance of legitimate profits (Tofangsz, 2015). As with the peso exchange, this method can also be used to move cash globally and informally.

The importance of this process is obvious, but Roberto Durieu (2013, pp. 19 and 98–119) says it took governments 50 years to begin taking legal action against money laundering. The first talk of anti-money laundering statutes began to appear in the United States in the 1970s, and it was finally outlawed in 1986, largely due to massive incomes derived from the sale of illegal drugs. The United Kingdom followed suit, and both nations began to support international efforts to stop money laundering in 1988.

Terrorist Financing

Terrorist financing refers to the methods terrorist groups use to raise the material needed to support operations and organizations. There are a variety of legal and illegal methods to meet income and other logistical needs (see the section entitled "Illegal Funding Methods"). Terrorists frequently engage in petty theft, robbery, kidnapping, selling illegal drugs, extortions, and any other economic crime. Terrorist financing also involves money from legitimate sources such as donations from a supporting group, wealthy supporters, and gifts from charities (Freeman, 2012, p. 7; Durieu, 2013, p. 69). According to the World Bank, terrorist financing refers to any money used to support terrorism, including people who support, plan, or engage in an act of terrorist violence (Durieu, 2013, p. 68). Funds may also be delivered by a combination of legal and illegal sources, and some groups are self-supporting or sponsored by states (Tofangsz, 2015).

There is no data evaluating the comparative sources for terrorist financing, and researchers are not clear on what types of sources have the most value. The importance of financing depends on the size of the group, its type of operations, and its particular needs of the group, and the ability to obtain resources (Tofangsz, 2015). Terrorists usually do not seek personal wealth, and they usually obtain resources to support terrorist activities (Durieu, 2013, p. 67). It is difficult to gather systematic information on the acquisition of money because groups or at least terrorist operations must be funded, but methods for doing so are varied.

Hamed Tofangsz (2015) believes that terrorists require three types of financing: cards, and checks—are used for weapons, bribes, and myriad other activities. Tangible goods are also an aspect of terrorist financing, but they are not as important as cash. These items include the things that are needed for everyday life—food, accommodations, clothing, travel, and anything else needed to carry out an operation. Finally, terrorist financing also involves intangible income. Groups need sanctuaries, training spaces, intelligence, and propaganda.

Tofangsz argues that terrorist financing develops in distinct phases. Terrorists need to obtain money, transport and store it, and distribute it to the operational group. Obtaining money involves fund-raising, and as mentioned, this happens in a



FIGURE 3.4 Stages of Terrorist Financing

variety of manners. Fund-raising is followed by security. Terrorists must be able to move and hold their financial resources. The final stage is distribution. Resources must reach individual terror cells.

Sometimes, economic support for terrorism does not involve actual money. Goods and services may be substituted for cash. Victor Dostov and Pavel Shust (2014) suggest that support may also come from a rapidly growing sector of the legitimate economy, customer loyalty programs. Airline miles, hotel and rental car points, and other customer bonuses can be traded for goods and services. These benefits can be used, in turn, to finance terrorism.

Customer loyalty rewards constitute a private economy, and programs have grown rapidly over the past 20 years. Awards of loyalty points from hotels, cash back rewards on credit cards, free rental cars, cash discounts for purchases, and frequent flyer miles have become a form of pseudocash. Reward programs have taken the character of surrogate payments in goods, services, and cash back incentives, making some of them act as private currency. International efforts to thwart terrorist financing do not have the resources to monitor the array of programs, according to Dostov and Shust, but terrorists may use them as income sources.

Loyalty programs do not fall in the realm of financial record keeping. However, Dostov and Shust point out that corporations keep extensive records on loyal customers, records that reveal transaction histories, behaviors, preferences, and exchanges to third parties. Companies also monitor rewards closely to avoid fraud. Most customer reward transfers are electronic, so they automatically create a record. In addition, there are few technical problems in gathering and analyzing data. It is usually as simple as entering a customer's name and reward identification number. Even though governments lack the capacity to investigate suspicious behavior, public-private partnerships could become a valuable tool in preventing or stopping terrorist financing if rewards are being used to support terrorism.

Dostov and Shust use the money laundering model—recall that it is placement, layering, and integration—to analyze customer loyalty programs, and they find potential risks. Terrorists may use points for purchases, rewards may be used across international borders, and customer loyalty awards are housed in an unregulated, decentralized private economy. If frequent flyer miles can be used for cash, cash cards, gifts of free flights, or private currency, they can be used to finance terrorism.

Comparing Money Laundering and Terrorist Financing

As awareness of money laundering grew, law enforcement agencies and intelligence organizations began to realize that terrorist financing might be a separate process using differing methods. At first, many governments and agencies began to employ anti-money laundering techniques to investigations of terrorist financing. In fact, after 9/11, when anti-money laundering programs permeated international counterterrorism efforts, many analysts equated terrorist financing with money laundering. Laws and operations that worked against laundering could be used to stop financing, or so many people believed.

Recently, financial analysts and economists have begun to question the logic of linking the two concepts. Approaching terrorist financing with anti-money laundering tools equates terrorism with organized crime. The two concepts are hardly identical. Organized criminals are in business to make money, and they launder illegal profits to enjoy their benefits. Terrorists fight for a cause, and when they reap profits, they only want to use them in support of that cause. Both organized crime and terrorism are based on money, but it is used differently in each case (Tofangsz, 2015).

Separating financing from laundering does not mean that terrorists do not launder money. When terrorists gain money illegally, they may need to hide its source. At other times, they may be using donors, charities, or some other entity where they avoid linking the money with its origin. For example, it is illegal to donate money to support terrorist groups in the United States. A donor may donate money to a front organization, and the recipient layers the money to give the appearance that it is being used for a purpose other than supporting terrorism. The donor's crime goes undetected, and terrorists get the funds. In such cases, terrorist groups employ money laundering techniques (Durtieu, 2013, pp. 69–70). Many times, however—maybe most of the time—terrorists have no need to launder money.

Think of it this way. Organized criminals use money laundering to obtain money and spend it. They commit the crime *before* they get the money. When terrorists raise funds, either legally or illegally, they usually commit the crime *after* they get the funds. Criminals seek resources to accumulate them, whereas terrorists want to disburse them. The difference between money laundering and terrorist financing is the direction of the flow of cash, goods, and services. This may mean that terrorist financing should be attacked with methods other than anti-money laundering techniques. Researchers and analysts, who see terrorism as a distinct category of crime, tend not to believe that anti-money laundering is an effective weapon in the arsenal of counterterrorism (Tofangsaz, 2013).

Terrorists and organized criminals move and store cash differently. To begin, much terrorist financing takes place in the legitimate economy. They can use banks, credit cards, check exchanges, and other legal economic transactions. When this is the case, there is no need to hide these activities from governments or law enforcement. Organized criminals begin with dirty money and must hide their initial transactions. Similarities may come into play when using underground networks because terrorists and criminals move along the same routes. When terrorists use informal financial methods to move and store cash, they deal with the same people who move and store cash for criminals. Yet, funds are moving in opposite directions. Terrorists are moving money to commit a crime, while money launderers are moving away from a crime. Money laundering requires a criminal predicate, whereas, terrorism does not (Tofangsaz, 2013).

Roberto Durtieu (2013, p. 70) points out that terrorists may need to make the money dirty. This process involves hiding the legal origin of money used to support terrorism. For example, in the United States, it is illegal to donate money to any designated terrorist group. Assume that a hypothetical donor wants to send money to a group whose cause he avidly supports, and the group wants the money. Yet, neither they nor the donor wants the source of the funds to be identified because the donor could be arrested. The money has to be “dirtied.” Layering takes place when the donor gives money to a legitimate organization, say a charity, and that organization gives it to another legitimate organization outside the country such as a nongovernmental organization (NGO). The NGO engages in legitimate activity while supporting the outlawed group. Since the money has been dirtied, it can flow to the terrorists. The donor has been protected.

Toward a Theory of Terrorist Financing

Some analysts believe the primary reason that officials do not understand the financing process is that they lack a theoretical framework. Graham Myres (2012) says that governments equate terrorist financing with money laundering because there is no theory of financing. Terrorism, he says, has been the target of social science studies but not financial research. Terrorists have financial strategies and disburse

funds. They acquire resources, fund operations, move money, and launder and dirty it. Myers concludes that analysts should create a theory to explain terrorist financing. It would enhance efforts to understand terrorism.

Michael Freeman (2012, pp. 3–12) of the Naval Post Graduate School is concerned about the lack of a theory to explain terrorist economics. He wants to place terrorist financing in some sort of framework. Without a theory, he argues, analysts cannot adequately explain how groups raise money, how money is budgeted, and how it is invested. Researchers also need to know how these processes change over time.

Freeman argues that researchers need a theory that accounts for the need for money, the amount of money needed, sources of income, and the interaction of these three factors with counterterrorist operations. He then proposes a framework to capture information based on six criteria: (1) the quantity of money needed, (2) the need for legitimacy, (3) the security of assets, (4) the sources of income, (5) the ability to control the flow of resources, and (6) the simplicity of a group's financial system. He says that all these factors will vary based on the importance of the criteria at a given point of time. As a group's needs change, some factors become less important while others become more essential.

Freeman's proposal can be explained by an example. Quantity and source of income would be crucial criteria for a group with few resources. In this situation, counterterrorist research and investigation should be directed toward the acquisition of funding. Another group might have an abundance of resources. This increases the importance of security and flow of funds. Such a theory, Freeman believes, enhances knowledge about operations.

Analysts do know that terrorist financing is critical because terrorists want as much money as possible. Freeman says that money is a force multiplier. Without it, a group is weakened. Groups with income can launch more attacks, maintain an infrastructure, provide goods and services, protect assets, and provide incentives to potential recruits. Good financing allows groups to build training camps, maintain logistical networks, travel, and purchase weapons. Money is important, and analysts need a theoretical framework to explain it.

	Self-Check
>	How is money laundered?
>	What are the differences between money laundering and terrorist financing?
>	How could a theory of financing increase our understanding of terrorism?

Efforts to Control Terrorist Financing

The financial environment is important to terrorists. Fund-raising is a business activity in the world of private corporations, and it is a business-like operation in terrorist organizations. Unlike corporations, terrorists are not in business to make money, but they need money to stay in business (Tupman, 2009). They also need a financial-friendly environment to flourish. Several countries in Asia, Europe, and North America have taken formal action to make their economies less friendly to terrorists. They have enacted laws to ban terrorist fund-raising and to regulate the banking industry. This makes the business of funding terrorism more difficult. Many nations lack the will or capacity to oversee their economies. These unregulated areas are conducive to crime and terrorism (Petrus and Amos, 2006, pp. 8–43). Even economically developed regions are vulnerable to private currencies like Bitcoin and underground economic networks (Brantly, 2014).

Regulation and Enforcement

After its long experience with the Irish Republican Army, the United Kingdom was one of the first nations to address terrorist financing. The British developed several tools to fight it. Parliament passed four specific laws against terrorist fund-raising before the start of the twenty-first century. One law simply banned possession of terrorist funds. Another prohibited any effort to assist terrorist groups in fund-raising. A third measure criminalized concealment of funds if money was connected to terrorism. Finally, if law enforcement or intelligence officials can establish reasonable suspicion that funds are connected to a terrorist group or an act of terrorism, the government is empowered to freeze all financial assets of anyone involved and to impound them (Ridley and Alexander, 2012).

Several other countries have followed the United Kingdom's lead, creating financial intelligence units and financial investigative forces. Such units gather information on transactions and provide a means to enforce compliance with economic regulations. Their goal is to reduce money laundering and terrorist financing, and they work very well in the banking industry and other financial exchanges in a formal economy. They regulate the flow of funds, but they have limitations. Their effectiveness depends on a nation's willingness and ability to regulate its financial system (Rashdan, 2012). Regulation works only in a formal, well-developed economy.

Nicholas Ridley and Dean Alexander (2012) examined regulations in the United States. Although in the past, the United States and United Kingdom led efforts against organized crime and money laundering, the United States did not pay too much attention to terrorist financing until the aftermath of 9/11. President George W. Bush issued an executive order that enabled the government to seize funds associated with any group on the State Department's designated terrorist list within days of the attacks. The USA PATRIOT Act further required financial institutions to report suspicious activity, develop anti-money laundering procedures, and to assess customers. President Barack Obama strengthened regulatory power in 2010 by criminalizing efforts to aid or support terrorist groups, even if actions take place outside of the country. In June 2010, the U.S. Supreme Court ruled that material support of terrorism included not only economic support but also provision of expert advice, training, services, and personnel. Ridley and Scott (2012) note that several federal agencies created financial enforcement and intelligence units. While the Internal Revenue Service (IRS) had a long-standing Criminal Investigative Division, the FBI created the Terrorism Financing Operations Section (TFOs). The Department of the Treasury created the Office of Terrorism and Financial Intelligence, and after the start of the Iraqi insurgency, it formed a financial investigative unit to gather, analyze, and distribute intelligence on terrorist financial networks in Iraq. The Department of State opened the Counterterrorism Financial Unit, and the Drug Enforcement Administration gathered intelligence on the nexus between terrorism and illegal drugs with the Office of Counternarcotics Enforcement.

Regulation, intelligence gathering, compliance, and enforcement increased, but Ridley and Alexander believe both Europe and the United States made a fundamental mistake. They equated terrorist financing with money laundering. European countries first recognized the mistake when they realized that efforts to stop the financing of al Qaeda were not working. Officials in the United States noticed this, too. It began to include efforts to uncover terrorist financing, expanding the tasks of investigative, and enforcement units.

Ridley and Alexander see this shift as a positive step, but they do not believe it has gone far enough. The United States needs to place more emphasis on terrorist financing. They also think that interagency squabbling over turf hinders intelligence

gathering activities, and they are dismayed that organizations continue to hoard information rather than share it. They urge greater scrutiny of seemingly innocent transactions and believe that government agencies should cooperate more with the private sector to uncover terrorist financing.

The U.S. efforts to regulate and eliminate terrorist financing extend beyond its borders. In Asia and the Pacific, it encourages developed and developing nations to expand their economies and adopt anti-terrorist financing measures (APEC, 2013). In Europe, it participates in a joint anti-terrorist financing measures (APEC, 2013). Finance Tracking Program (FTFP). The FTFP began as a secret American intelligence gathering program, and it eventually emerged as a formal regulatory agency in the European Union (Plachta, 2014). The United States also seeks to implement uniform anti-money laundering and terrorist financing regulations around the globe, in both developed and developing regions (FATF, 2014).

Efforts by the United Nations

Terrorist financing and money laundering usually involve international funding, and they have become part of the global economy. At the urging of the United States and the United Kingdom, the UN General Assembly adopted the International Convention for the Suppression of the Financing of Terrorism in December 1999. It was later strengthened by the addition of provisions that criminalized terrorist financing, empowered governments to seize and freeze assets used by terrorists, and required financial institutions to report suspicious behavior (Thony and Png, 2007).

Another important action was the creation of the Financial Action Task Force on Money Laundering (FATF) a decade earlier and its subsequent strengthening in the twenty-first century. Its purpose was to bring the international financial community into harmony by strengthening regulations and introducing more uniform practices. FATF originally contained 40 recommendations, and it was strengthened when nine special recommendations that targeted terrorist financing were added between 2001 and 2006. The special recommendations called for more regulation, reporting suspicious activities to law enforcement, and moves against informal economic systems (Troutsooul and Johnson, 2012).

The nine special recommendations asked all member states to implement UN financial instruments. They also reinforced previous efforts to criminalize terrorist financing, asset seizure, and suspicious activity reporting. The fifth recommendation called for international cooperation in investigation and law enforcement efforts against terrorist financing. Later measures asked for stronger anti-money laundering standards, rules for wire transfers, monitoring NGOs, and measures against suspects transporting cash (Thony and Png, 2007; Ohman and Amet, 2014). On the surface, FATF appears to be very strong.

Critics and terrorism analysts note several weaknesses in FATF. The first has little to do with financing and reverts to the problem of defining terrorism. Debates about the meaning of terrorism allow funds to flow to terrorist groups. For example, a government may consider a paramilitary group to be a terrorist organization, but another nation might see the same group as a legitimate revolutionary or liberation movement. The first nation outlaws the group because it practices terrorism, and the second nation supports the group as an ally. International prohibition of terrorist financing is impossible without a standard definition, and as W. A. Tupman (2009) notes, there is still no standard definition of terrorism, and nobody is close to providing one.

There are other shortcomings in FATF. Critics note a widespread absence of laws allowing the seizure of assets used to support terrorism. Much of FATF is aimed

Suppression of the Financing of Terrorism: A 1999 UN resolution designed to thwart terrorist financing. It was strengthened after 9/11 by provisions that criminalized terrorist financing, empowered states to seize terrorist assets, and required financial institutions to support suspicious activities.

Financial Action Task Force on Money Laundering (FATF): A resolution passed by the United Nations in 1990 and strengthened from 2001 to 2006 urging member states to adopt measures to hamper money laundering and terrorist financing. It contained 40 recommendations. Nine special recommendations were added to focus specifically on terrorist financing.

at informal financial systems, but transactions in these markets take place in secret, where government regulations do not apply. Criminals using these markets are likely to keep informal networks secret, and the majority of people who use them have no criminal intention. They simply do not have access to institutions such as banks. Even when the formal system is discussed, many countries have neither the means nor the will to enforce the recommendations (Thony and Png, 2007).

Enforcement efforts aimed at underground networks are ineffective and often counterproductive in developing countries. In fact, informal systems may well be the thriving sector of an undeveloped nation, and its people may view them as normal and acceptable. Informal exchanges usually take place in cash so that there are few records, which makes transactions difficult to trace. Many people see FATF as an attempt to impose regulation of traditional economies, and the recommendations often violate cultural, social, and religious practices. FATF is ill suited for many areas of the world (Trausolt and Johnson, 2007).

Critics also have concerns about due process. Assets can be seized and frozen based on the suspicion of terrorist activity. This means that a government may take action before prosecuting a suspect. It also implies that a person can lose assets because he or she is associated with a person or organization engaged in suspicious activity. For example, assume that a charity is financing a terrorist group. A large donor might have assets seized simply because he or she is associated with the charity. This could happen without formal charges or criminal prosecution (Plachta, 2014). The United Nations tried to remedy this by allowing individuals to petition the government for a formal hearing if assets are frozen (Thony and Png, 2007).

Despite criticism, supporters claim that FATF works well in economically developed countries. It promotes risk assessment and transparency in the banking sector, maintains communications with nonprofits and NGOs, supports expansion of regulation, and seeks to improve efforts against money laundering and terrorist financing. It actively monitors states that are unaware of or supporting illegal monetary practices and maintains a list of noncooperative nations (FATF, 2015). Rick McDonnell, the executive secretary of FATF in 2015, points out that a global anti-money laundering and terrorist financing is a complex, massive undertaking. FATF operates without treaties or enforcement powers, and it relies on peer pressure and diplomacy to achieve compliance. This means it cannot change established economic practices in a brief span of time. Regulation and reform of financial systems will evolve slowly over time, and laws based on FATF recommendations have produced financial intelligence that has led to prosecutions for terrorist financing. McDonnell also points out that a top-level minister represents every nation that is involved in FATF (Millman, 2014).

Qualitative data also suggest that efforts like FATF are important. It is difficult to assess the effectiveness of anti-terrorist financing measures because researchers lack the data and means to create an accurate assessment of anti-terrorist financing regulations. Simply studying conviction rates underestimates their effectiveness, and comparing convictions across international borders in varied economies produces misleading data. Current and former intelligence and law enforcement officials, however, see the situation in a different light. Qualitatively, FBI agents believe that dozens of terrorist convictions have resulted, and several terrorist plots have been stopped because banks reported suspicious activity. Law enforcement agencies in Europe feel the same way. Intelligence agents believe that anti-money laundering and terrorist financing activities provide hundreds of leads. While critics are leery of regulatory measures, practitioners believe that regulations developed from FATF recommendations can be used to stop terrorism (Jonsson, 2010).

The international economy is a morass of differing systems separated by currencies, traditions, cultures, mores, and a host of other issues. There are systems within systems, and the intermeshed international economy is susceptible to fraud, criminal behavior, money laundering, and terrorist financing. Any attempt to counter criminal financial operations is destined to be complicated. It may be easy to find the weaknesses with FATF, but it represents an effort—a massive effort—to counter money laundering and terrorist financing. The long-term focus is improvement of monetary systems, increased security, and compliance. Improvement over time will probably be the best measure of FATF's effectiveness.



- > What efforts has the United States made to combat terrorist financing?
- > What is the purpose of FATF?
- > What are the strengths and weaknesses of FATF?

Financial Information as an Investigative and Intelligence Tool

When security officials began to believe that money trails would be the best tool to use against terrorism, they equated terrorist organizations with drug gangs and organized crime. Conventional wisdom suggested that terrorist groups could be dismantled simply by “following the money.” There were arguments for waging “financial warfare” by freezing assets and tracing the funds used by terrorist groups (Navias, 2002). The U.S. government endorsed this approach, arguing that counterterrorist investigations should focus on sources of financing and mechanisms to transfer money (National Strategy for Combating Terrorism, 2006, p. 7). These financial approaches supposed that attacks on terrorist financing with anti-money laundering tactics would reduce terrorism.

This approach was too simple. It assumed that terrorists would act only in the legal, formal economy. In reality, terrorists participate in underground criminal networks that are relatively immune to financial regulations. So-called formal financial warfare would not be effective because underground economies operate under different rules (Bastile, 2004). Experience in Canada suggests that conventional financial investigations against terrorists are ineffective and that traditional measures do not work, at least on the surface (Montpetit, 2008).

As criticism of counterterrorist financial investigations increased in the media and among the public at large, security forces came to realize that the nature of money trails in terrorism was misunderstood. Many people assumed that terrorists operated like drug networks, but that was not the case (Giraldo and Trinklunas, 2007, p. 293). Whereas, an intensive financial investigation of money laundering networks could result in the successful prosecution of an international drug ring, the same tactic did not work against terrorist groups. This was true even with large, international networks. Counterterrorism specialists and investigators came to realize that financial investigations could be used as a tool in a process, but by themselves, investigations of the flow of funds would not stop terrorism.

Drug dealers and organized criminals do not operate like that. Terrorists and launder large amounts of money. Terrorists do not operate like that. Terrorists do not launder money frequently, as noted earlier, it takes relatively little money to

launch an individual terrorist operation (Liu, 2012). Traditional financial investigations are not effective against terrorists because of the limited amounts of money required for a terrorist operation, but when financial transactions become one aspect of larger investigative or intelligence operations, they help to provide a comprehensive picture. Terrorists do need money, and they get it by both legal and illegal methods. Financial information is added to evidence gained by other investigative techniques. It can provide a more comprehensive picture of terrorist activities (Levitt and Jacobson, 2008, p. 15).

Terrorist networks operate much like a business franchise, although transactions frequently take place in the underground economy. Money is moved across international borders. Therefore, financial investigations are conducted internationally and require international agreements to stem the flow of money. As a result, one aspect of counterterrorism involves tracing money and using the information in concert with other intelligence to produce a comprehensive picture of terrorist operations (Williams, 2007, pp. 77–82; Levitt and Jacobson, 2008, p. 15).

John Casara (2006) argues that the United States has been less than effective in its efforts to fight terrorism because law enforcement agencies have not used sufficient forensic accounting tools. It is possible to track terrorists' money laundering, cash purchases, banking accounts, and stock and business investments. Casara also says that tracking money can create better intelligence—criminal intelligence and national security intelligence. Mapping the financial activities of suspected groups and individuals gives intelligence a comprehensive focus. Forensic accounting can be used to solve crimes and to gain information.

Illegal Funding Methods

Terrorists raise money by a variety of legal and illegal means. Some of the illegal methods include running criminal enterprises, engaging in the drug trade, conducting illegal business activities under a legal cover, smuggling money, illegally transferring money, and a variety of other methods. Middle Eastern terrorists engage in smuggling and document fraud. Document fraud raises money for terrorist organizations and provides terrorists with false identification. In Central Asia, terrorist organizations and trade illegal arms, launder money, and distribute drugs. Latin American terrorism is tied to drug production and public corruption. In the United States, domestic terrorists engage in fraud schemes and robberies to finance political violence (Mili, 2006).

Raising money for illegal operations is nothing new. The Brazilian terrorist-philosopher Carlos Marighella argued that “urban warfare” begins with a campaign of expropriation—that is, robbery (1969, 1971; see also Burton, 1976). Terrorists around the world use a variety of criminal methods to raise funds. Violent activities involve kidnapping, extortion, and robbery. Less violent methods include fraud, larceny, smuggling, dealing in contraband, forgery, and counterfeiting (Nance, 2003; Williams, 2007, p. 77). Interpol estimates that counterfeiting and intellectual property theft is responsible for \$200 billion annually in illegal profits in the United States alone, and the amount doubles to \$400 billion when the international community is included. This involves pirated CDs and DVDs, counterfeit clothing, and stolen computer software (Noble, 2003). Counterfeiting and fraud are common practices among the American extremist right (Pitcavage, 1999a, 1999b, 1999c).

Domestic extremists are not the only violent fanatics who raise funds in the United States; international terrorists also engage in fraudulent activities in America. From approximately 1981 to 1986, the Abu Nidal Organization engaged in various criminal activities in Tennessee and the St. Louis metropolitan area to generate funds

(E. Harris, 1995). Hezbollah ran cigarettes from North Carolina to Michigan and used some of the profits to fund operations in Lebanon (*United States of America v. Mohammad Yousef Hamoud, et al.*, 2002). There are a variety of schemes across the country that use baby formula. American baby formula is treasured throughout the world because of its nutritional value. Terrorists sometimes steal formula and use illegal distribution networks to raise money (Clayton, 2005). In Cincinnati, law enforcement officers broke a ring of convenience stores that were selling stolen goods to finance terrorist organizations (Coolidge and Prendergast, 2003). Police in Dearborn, Michigan, arrested two men for making false identification papers for Middle Eastern groups (U.S. Immigration and Customs Enforcement, 2005).

The Internet has become a tool for fraud. Terrorists use online activity in identity theft and in gaining access to bank and credit card accounts. They also sell items at Internet auctions. Security fraud is another method of raising funds. For example, a group might buy a large amount of stock in a company that is fairly inactive. They then fill the web with stories of new products, new technology, or some other item that will cause the company's stock to increase. As the stock value increases, terrorists sell the stock at an inflated price even though the company has seen no real increase in value. Before the stock drops back to its normal level, the terrorists make a huge profit. This process is known as pump and dump, and it is frequently used by dishonest stock speculators and other criminals (Hinnen, 2004).

Terrorists use extortion and protection rackets to raise money. Terrorist organizations force legitimate businesses and other people to make payoffs to avoid being attacked. Loretta Napoleoni (2003, pp. 27–28) reports that the Shining Path of Peru taxed farmers for protection. Rebels and death squads in Colombia did the same. Zachary Abuza (2003b) says similar tactics are used in Southeast Asia. In essence, Abuza concludes, terrorists use the same fund-raising techniques that criminals have used for years, in addition to their unique methods of gathering money.

Stolen vehicles also play a role in fund-raising (Sallot, 2006). North American cars, especially SUVs, are attractive to terrorists. When used as car bombs, the large capacity of SUVs provides far more explosive power than smaller vehicles. They can also be used to raise cash. A stolen SUV can be sold in the Middle East or Central Asia for nearly \$100,000.

Examples of illegal fund-raising extend to all forms of crime. At the heart of illegal activity is fund-raising, and terrorists have learned that crime can pay. Traditional crimes, especially large embezzlement schemes in the global economy, represent a source of income for small groups as well as large organizations (Labbeverie, 2000, pp. 54–55; Napoleoni, 2003, pp. 203–205; D. Kaplan, 2005). After raising funds, terrorists frequently spend them in underground networks to support operations.

Tobacco has become an important source of money for terrorist organizations. By 2012, al Qaeda in the Islamic Maghreb (AQIM) had become the primary source of income for the al Qaeda network (Rogers, 2012). AQIM achieved this prominent position by smuggling cigarettes. David Cid, former director of the Memorial Institute for the Prevention of Terrorism, says that cigarettes are easy to buy and easy to smuggle. They can also be counterfeited. The Afghan Taliban produces millions of fake Marlboros and distributes them through Afghanistan and China. The Irish Republican Army raised an estimated \$100 million over a five-year period by smuggling cigarettes. The Kurdish Workers Party raises money by taxing cigarettes as they cross the border. Many of the drug smuggling routes in North America have been used for cigarette smuggling. Drug detection methods do no work against cigarettes, and penalties for illegally possessing cigarettes are much lighter than those for possessing drugs (Wilson, 1999).

Expropriation: A term used by Carlos Marighella to describe the act of an armed robbery.

Legal Methods of Raising Funds

Terrorists do not limit their financial activities to underworld networks and illegal revenue sources. Many groups engage in legitimate business activities to raise and distribute money (Navias, 2002). Activities include soliciting contributions, operating businesses, running nongovernmental organizations (NGOs), creating charities, using wire transfers, forming or using banks, and using informal money transfer systems. Sometimes, people smuggle large amounts of money across international borders. At other times, foreign workers send money back to organizations in their home countries. One terrorist group legally raises the money through normal employment (National Strategy, 2006; Levitt and Jacobson, 2008; and Montpetit, 2008).

According to several researchers (Emerson, 2002, pp. 183–219; Ehrenfeld, 2003, pp. 21–22; Napoleoni, 2003, pp. 111–179), charities have been involved in funding terrorism. Data from national and international law enforcement sources agree with these findings (Scott-Joynt, 2003; Isikoff and Hosenball, 2004; U.S. Department of State, 2004b). Many people who contribute to charities do not know they are supporting terrorist organizations. Others believe the efforts they are supporting are not terrorist operations; rather, they see them as legitimate military operations. Zachary Abuza (2003b, p. 93) writes that terrorists often set up a phony charity or skim the proceeds from legitimate organizations. Either way, charitable funds are frequently diverted to terrorist groups.

Self-Check

- > How do financial tools impact investigative and intelligence functions?
- > What are some of the common illegal methods of funding terrorism?
- > What types of legal activities fund terrorism?

Underground Networks and Systems

David Carter (2009) points to an important characteristic of terrorist organizations. When terrorists move goods, people, weapons, money, or contraband, they must do so through underground networks. It is not possible to build a network overnight; they develop only through long-term trust. This means, Carter concludes, that terrorists use existing criminal networks for logistics, including financing activities, and they are vulnerable to intelligence-gathering activities. Even researchers who disagree about the stability of networks see the importance of the underground economy (Biersteker and Eckert, 2007). Even if illegal economic routes are not stable, money still flows through a network. The examination of underground economic systems shows links among people and groups.

The FBI estimates that the global underground economy produces \$500 billion per year. An underground economy requires secret institutions, and terrorists have found various enterprises for hiding money (Maier, 2003). Rachel Ehrenfeld (2003, pp. 10–30) says that terrorists run banks and create phony companies to launder or hide their funds. They also engage in secret transactions and form alliances with organized crime. Friedrich Schneider (2002) says the underground economy and its ties to crime are so important to terrorists because all the transactions remain hidden. Organized criminal and smuggling networks have long had the means of hiding money through seemingly legal transactions. Terrorists take advantage of these networks. Schneider believes that terrorism has become a big business. Terrorists not only move funds but also smuggle stolen goods and contraband. As mentioned earlier, document fraud and forgery are money-raising activities.

Terrorism is linked to organized crime throughout the world, and in some cases, it is almost impossible to distinguish between terrorist and criminal activity. Tamara Makarenko (2002) says that Russian organized crime groups trade weapons for drugs in Colombia. She also finds that both terrorists and criminals take advantage of political instability in regions like Central Asia and the Triborder region in South America (around the common border of Argentina, Brazil, and Paraguay; Figure 3.5). In the Middle East and Southeast Asia, terrorists and criminals kidnap for profit. She believes that terrorist and criminal organizations have grown into global enterprises.

The globalization of crime and terrorism has created opportunities for vast profits in the diamond trade. African diamonds, or “conflict diamonds,” are obtained illegally and sold through an underground network. According to Global Witness (2003), a British human rights organization, al Qaeda spent 10 years moving into unregulated diamond trading in West Africa. In the early 1990s, it infiltrated legitimate trading centers to establish a base. After success in mainstream trading, al Qaeda slowly and quietly switched from legitimate trading centers to underground criminal networks. Then, taking advantage of weak governments and regulations in Africa, it established its own international trading network. The new system allowed al Qaeda and allied jihadist groups to make tremendous profits while providing a ready-made network to hide and launder money. It should be noted that the 9/11 Commission (2004, p. 171) examined claims about al Qaeda’s involvement in the diamond trade and came to a different conclusion. The commission found no evidence that diamonds were used to support al Qaeda. Global Witness disagrees and believes it has presented evidence of al Qaeda’s activities.

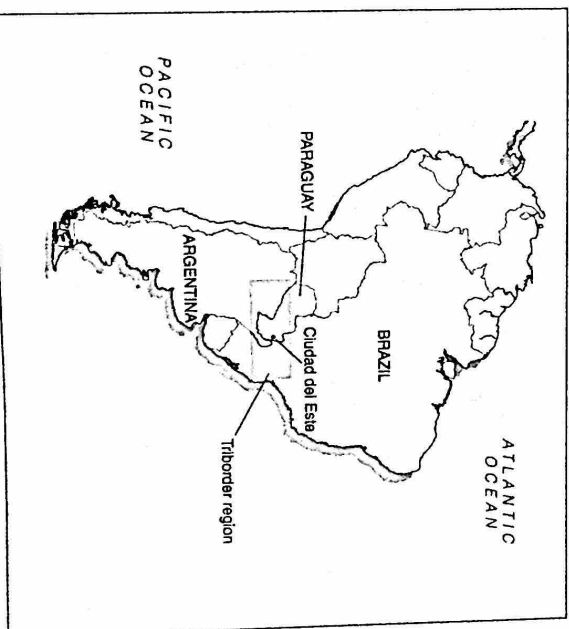


FIGURE 3.5 The Triborder Region

Triborder region: The area where Brazil, Paraguay, and Argentina join. The major city is Ciudad del Este.

Globalization: A common global economic network that ideally unites the world through production and international trade.

Proponents believe it will create wealth. Critics believe it creates corporate wealth and increases the distance between the rich and the poor.

The Tri-border region is the area in South America where Paraguay, Brazil, and Argentina have a common border. Quite a bit of criminal activity takes place in the region, and the Paraguayan city Ciudad del Este is particularly known for its lawlessness. The region is also home to more than 20,000 Middle Eastern immigrants, the Hamas, Hezbollah, and other terrorist groups have been known to frequent the area.

The Hawala System

Informal financial networks are hidden from public view, and transactions take place in a self-regulated, underground market. Probably the most well-known hidden financial exchange is an ancient trading network called the Hawala system. Many international criminals and terrorists funnel money through it. The system originated several hundred years ago in China under the name of Feng Chin, or "flying money." Today, it is primarily used in Pakistan and India, though there are Hawala dealers around the world. It is a legitimate means of transferring money without using money or moving actual funds across international borders, although it may violate currency transfer regulations in some countries. It is a network based on long-term trust relationships and the knowledge that each dealer is impeccably reliable for all debts (see the section later in this chapter titled "Expanding the Concept: Advantages of the Hawala System").

Several hundred years ago, Central Asian merchants were frequently robbed of the gold and silver they carried in caravans to pay for goods. They developed a system of noncash exchange as a result. Rather than carrying money, caravan leaders would visit merchants and pay for goods with a promissory note. When the caravan reached its destination, the leader sold his goods, and the distributors would pay the caravan leader with promissory notes. The leader returned home and presented the note, and the local chit dealer paid the debt. The system worked because the dealers honored the promises. As long as people trusted each other, each chit was worth silver or gold, and merchants, caravan leaders, and others could thus travel without money. The Hawala system is one version of this ancient practice (Jamwal, 2002; Schramm and Taube, 2002; Sharma, 2006).

Today's Hawala system works much as the old system did (Figure 3.6). Imagine that Asadullah Kahn lives and works in Los Angeles. He is an American citizen, but his parents live in Peshawar, Pakistan. Asadullah wishes to assist his parents, so he regularly sends them money. It is difficult, however, to get funds into Pakistan, and it is even more difficult to move them across the North-West Frontier Province to Peshawar. Postal service is frequently unavailable, and parcel services can take months to deliver a package. Therefore, Asadullah goes to a local jewelry store because he knows the owner is a *Hawaladar*, a Hawala dealer. Asadullah gives the *Hawaladar* \$500 and tells him that he wants it delivered to his parents. The *Hawaladar* subtracts a small fee,

- Advantages of the Hawala system:**
- Money moves with no record.
 - Money crosses international borders with ease.
 - It is based on trust, and long-term trusting relationships are in place.
 - Money can easily be bartered for contraband.
 - No tax records exist.

EXPANDING THE CONCEPT

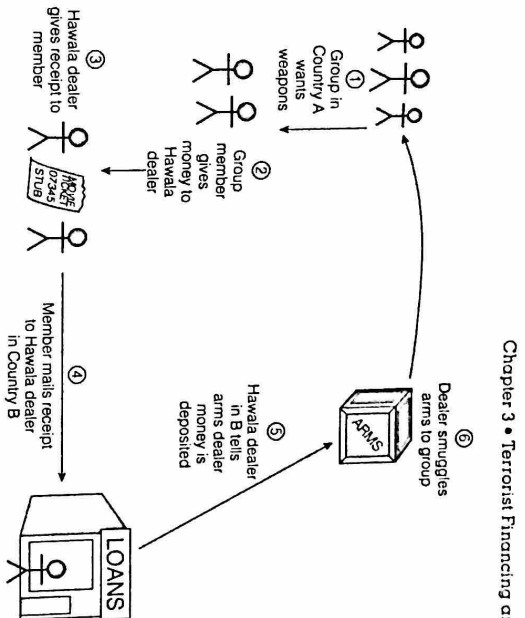


FIGURE 3.6 The Hawala System

usually 1 or 2 percent, and sends word to a *Hawaladar* in Peshawar that Asadullah sends his parents the balance. Asadullah's parents visit the Peshawar *Hawaladar*, and he pays them the promised money. No money actually moved from Los Angeles to Peshawar, but Asadullah's parents received nearly \$500. The system works because the *Hawaladars* in Peshawar and Los Angeles implicitly trust each other. They know the debt will be honored (see U.S. Department of the Treasury, 2003).

Change the imaginary scenario a bit, and the impact on terrorism can be demonstrated. In the revised situation, imagine that Asadullah is not a hardworking son seeking to support his parents but an operative for the Lashkar-e-Taiba, a Kashmiri terrorist group. Asif, Asadullah's contact in Peshawar, needs \$5000 to buy AK-47s. After raising funds in the United States, Asadullah visits the *Hawaladar*, hands over \$5000, and asks the *Hawaladar* to get the money to Asif. The Peshawar *Hawaladar* gives Asif the money, not knowing its use. Asif buys the weapons and delivers them to contacts in the Lashkar-e-Taiba. There is no record of the transaction and no way to trace the flow of funds. The Hawala system was not established to support terrorism, but it hides transactions in the modern world of international banking (Sharma, 2006).

Hezbollah as an Example

Hezbollah can serve as an example of the complexity of terrorist financing (Levitt and Jacobson, 2008, pp. 65–68). The group is discussed in full later in this text, but for now, please understand that it is a political party, a social welfare organization, and a militant group. It uses all types of sources for funding, and it moves money in underground networks and laundering systems. Most of Hezbollah's funds come from state funding, with Iran acting as the principal sponsor. Hezbollah receives an estimated \$200 million per year from Iran. There are numerous Lebanese Shi'ites dispersed throughout the world, and Hezbollah receives quite a bit of money in direct

donations from members of the Lebanese diaspora. Charities and other front organizations around the world also serve as a base for funding. One charity forwarded \$50 million a year to Hezbollah before its activities were stopped by law enforcement.

Hezbollah also relies on criminal activities in Lebanon and in other countries. One of the main sources of illegal income inside Lebanon is an extensive protection racket. Legitimate businesses are forced to pay a "Hezbollah tax" to ensure that their property will not be damaged and that their personnel are not harmed. Hezbollah also involved in narcotics trafficking and cigarette smuggling in North America and Africa. The organization is so complex that it even manages legitimate businesses, and it controls branch offices for international wire services. Finally, the group is so well funded that it is able to finance other terrorist organizations such as Hamas and the Palestinian Islamic Jihad (Levitt and Jacobson, 2008, pp. 65–68; Chalk, 2012).

Self-Check

- > What impact do underground financial networks have on terrorism?
- > How does the Hawala system operate?
- > How does Hezbollah embody the complexity of terrorist financing?

The Political Economy of Terrorism

The financial aspects of terrorism have influenced the changing nature of the international economy. After the collapse of the former Soviet Union in 1991, the United States became the world's only superpower. Promoting an economic system that emphasized international production, trade, and consumption, American economic policies focused on reducing the trade barriers between nation-states. Some countries have prospered under globalization of the world economy, but others have grown weaker and poorer. Globalization is based on the belief that international trade barriers should be removed so that commerce and industry can develop in an international free market. Terrorism has taken hold in some of the areas left behind in the rush toward globalization, and this has changed the nature of terrorist financing (see Barber, 1996, pp. 48–49).

Loretta Napoleoni (2003) examines this process, formulating a new theory about the financing of terrorism. Agreeing with Adams's early findings and other studies that found links between organized crime networks and terrorism, Napoleoni goes far beyond a summary of the immediate circumstances. In *Modern Jihad*, she argues that terrorism has evolved as an economic entity. The fall of the Soviet Union and subsequent globalization have produced what she calls the new economy of terrorism. Napoleoni says that the origins of the new economy of terrorism grew from the Cold War (1945–1991). As Bruce Hoffman (1998, pp. 43–65) says, colonial revolts began at the end of World War II, and Napoleoni (2003, pp. 11–28) sees this as the beginning of a macroeconomic shift. Western nations began to use underground methods to fund their struggles in the colonies, and revolutionaries sought their own sources of money. The origins of the new economy of terrorism can be traced to anti-colonial revolts.

To demonstrate the birth of this new economy, Napoleoni turns to France. After World War II, when France was still a colonial power in control of many foreign lands, nationalists revolted against French rule all over the world. In Vietnam, the revolutionary nationalists were called the Vietminh. Although they had international Communist backing, the Vietminh needed money. They muscled their way into opium production, sold the drugs, and used the profits to keep their guerrillas in the field.

Ironically, France tried the same concept. When the war against the Vietminh became politically unpopular, the French government found it difficult to finance military operations. Napoleoni says the French took over opium profits and used them to finance the war. As a result, drug trafficking became one of the primary methods governments used to finance activities during the Cold War.

Napoleoni says that as the Cold War developed, the Soviet Union and the United States fought each other by proxy; that is, they did not fight each other directly. The Soviets used allies to attack countries loyal to the United States, and the United States used its friends to attack Soviet-backed countries. Napoleoni believes that modern terrorist groups evolved from these surrogate conflicts and that they looked for ways to become independent from both superpowers. The desire for autonomy led terrorist groups to join criminals in an underground economy.

Napoleoni cites several examples to support this idea. She says a radical Marxist group in Peru, the Shining Path, turned to the drug trade in northern Peru, regulating drug production to fund their activities. The Revolutionary Armed Forces of Colombia (FARC) went a step further and joined the Colombian drug trade. Militant Palestinians went in another direction, using robbery and extortion to raise funds. The IRA started diverting funds from American charities before turning to organized crime. Napoleoni says these sources of financing fueled most of the terrorist activities of the 1970s and early 1980s.

The ETA (separatist group in Spain) changed the structure of terrorist financing. Instead of seeking links to an underground economy, ETA tried to gain control of the economy. They forced Spanish businesses out of the Basque areas of northern Spain and weakened the entire state. The Basque region became a failed state, a place where Spain could no longer exert power. When this happened, ETA established an illegitimate economy in a shell state. It paid salaries to terrorists, provided for the families of fallen members, and even ran a pension system for retired terrorists. ETA was successful because the Spanish economy had failed in the Basque region, leaving the area in a hopeless political mess. ETA was strong enough to enforce stability.

The new terrorist economy can be understood from the example of ETA. Napoleoni believes that globalization has created pockets in the world where failed or weak states are left to govern with little economic or political power. Terrorists and criminal groups grow in such places, running their own underground economies and providing some form of political stability because they are strong enough to resist the state. Illegitimate groups form a shell state, an organization that acts as a government in a place where the government is not strong enough to act.

As globalization increased, according to Napoleoni, it not only created economic vacuums where shell states could form but also fueled the growth of a global underground economy. It provided illegal trade routes for drugs, arms smugglers, counterfeiters, and human trafficking. Terrorist groups funded themselves through these activities, and they could not exist without them.

Napoleoni believes that modern terrorism is an international force supported by groups in shell states that continually change both their organizational structures and political goals to maintain income from an international underground economy. They hide their economic views with religious rhetoric or patriotic slogans, but their most important objective is to raise funds. Without funding, a terrorist group cannot exist. The prime goal of a group, then, is to maintain its finances. Napoleoni concludes that powerful groups even become strong enough to invest in legitimate markets, and in some instances, they move so much money that they affect the global economy.

Complementing Napoleoni's work is a model developed by Mario Ferrero (2002), who argues that modern radical Islamic groups use violent activity as a means of

failed state. An area outside a government's control. Failed states operate under differing warlords, criminal groups, or competing governments.

shell state. A political situation where a government nominally controls its own state but where large regions are either anarchic or under the control of others. A government is unable to enforce law or provide for other forms of social order in a shell state.

onomy of terrorism: used by Loretta Napoleoni to describe the origins of terrorism from the beginning of the Cold War to the present. Eco- support and anti-terrorist policies interact to new economy.

providing economic stability. Jihadist groups cannot keep outsiders away or fire squads for being unproductive. Numerous recruits flock to training camps and meetings, including people who are less than totally motivated. The slackers threaten stability by using a group's limited resources. To control this, jihadists increase the threat of violence to drive all but the most loyal members away from the group. This leaves enough resources to support the true believers.

Jeanne Giraldo and Harold Trinkunas (2007, pp. 7–11), of the U.S. Naval Postgraduate School, suggest that the political economy of terrorism is related to failed states and areas where governments cannot exert political control over their own territory. This has resulted in autonomous terrorist groups with their own funding sources. The terrorism generated by such groups is not related as much to a new style of terrorism or religious motivation as it is to their ability to generate funds. They control their economic circumstances, and funding creates violence.

Like Napoleon, Giraldo and Trinkunas believe that the old Marxist groups were constrained by their sponsors. Unlike Napoleon, they do not see the long emergence of a political economic system through the evolution of Cold War financing. They believe that the key is self-sufficiency. Financial and political autonomy allows terrorists to operate without the constraints of a sponsor. Further, by participating in the global economy, they can function much like a government, controlling the flow of cash, goods, and services.

If these macroeconomic theories of terrorism are correct, they have meaning for the nature of counterterrorism. Many criminologists believe that crime can be reduced when potentially deviant groups have a vested interest in the economic structure of society. Macroeconomic theory suggests that counterterrorism policies should be aimed at providing the world's peoples with economic stability, opportunity, and participation in the mainstream economy (see Barnett, 2005, p. 49). Economic policies to counter terrorism would thus involve supporting states in danger of failure, providing opportunities for people to participate in and benefit from economic systems, and eliminating underground economic networks. When a state fails and a terrorist group creates its own shell state, the group has no incentive to participate in legitimate economic enterprises. As Benjamin Barber (1996, p. 299) says, when economic globalization threatens the ability of ordinary people to meet their needs, they will find other ways to survive. Indeed, this reflects Napoleon's thesis. Poverty does not cause terrorism, but economic and political failures may result in a shell state where terrorism can be organized and funded.

Self-Check

- > What is a macroeconomic theory?
- > How does it apply to terrorism?
- > What political assumptions must be made to see the logic of a macroeconomic theory?

Narcoterrorism

narcoterrorism: A controversial term that links drugs to terrorism in one of two ways. Either drug profits are used to finance terrorism or drug gangs use terrorism to control production and distribution networks.

A heated issue surrounding the discussion of terrorist financing is the relationship between terrorism and drugs. The term *narcoterrorism* refers to groups using either terrorist tactics to support drug operations or drug-trade profits to finance terrorism. Rachel Ehrenfeld championed the concept of narcoterrorism in her early works,

and she expanded on the idea (Ehrenfeld, 2003). According to her research, terrorists are involved in the international production and distribution of drugs; indeed, she believes that the narcotics trade is one of their primary sources of money. The U.S. government tends to accept this position, but it is nonetheless extremely controversial.

The Link Between Drugs and Terrorism

Steven Castel (2003), an executive with the Drug Enforcement Administration (DEA), told a U.S. Senate committee that terrorism and the drug trade are intertwined. Organized criminals, smugglers, and drug dealers naturally linked up with terrorist groups, he says, because all these organizations move in the same circles. Like Napoleon, he believes that globalization has intensified this relationship. He says that the relationship between drugs and terrorism has been in place throughout history.

David Adams (2003), reporting for the *St. Petersburg Times*, says that Hezbollah and Hamas use the Latin American drug trade to raise funds. He writes that U.S. military units have tracked their activities in South America, and the military is concerned about the large amount of money involved. According to the U.S. Central Command, hundreds of millions of dollars have been raised in Latin America. The military's prime concerns are the Triborder region, the Venezuelan island of Margarita, and the areas controlled by FARC in Colombia. The DEA agrees with this assessment. An official from the U.S. Department of State puts it succinctly: "Whether it is from Latin America or elsewhere, terrorist groups are financed through drugs. This is demonstrable, not debatable" (J. P. Walter, 2002).

Other governments also believe that terrorism and drugs are linked. The French Ministry of Defense issued a report stating that drugs are the primary currency used to finance international terrorism. The French government points to the Shining Path and FARC to show the influence of cocaine. The ministry claims that radical Islamic groups get most of their money through the drug trade in Central and Southeast Asia. Afghanistan is the primary source of heroin in Europe, and the profits from these drug sales fund all international Islamic terrorist groups (Chouvy, 2004). Officials in India believe that Lashkar-e-Taiba and al Qaeda have smuggled drugs and other contraband through Africa, Central Asia, and Eastern Europe (Times of India, 2003). According to many in the Indian government, militant Islamic groups are funded by the drug trade.

Joshua Krassna (1997) takes the argument to another level. He says that if people are willing to expand the definition of national security beyond the framework of military defense, drugs pose a security problem. Defining security as social safety, Krassna says that the drug trade threatens political and economic stability by disrupting society. The drug trade limits the ability of legitimate governments and increases the power of insurgent and terrorist groups. Terrorists, for their part, use drugs not only to exploit the social safety concerns of their enemies but also to fund terrorist activities.

Nothing illustrates Krassna's point better than the unfortunate situation in Mexico. Seven major drug trafficking organizations dominate the political landscape in northern Mexico. Officially labeled drug trafficking organizations by the U.S. government, these drug cartels bring a high level of criminality to the U.S.–Mexican border. Violence spills over into Arizona and Texas, and the cartels have directly influenced urban gang activity in Los Angeles, Chicago, New York, Dallas, and San Francisco. Another alarming trend is the link between one of the groups, Los Zetas, with Hezbollah. This has spawned concern over an emerging link between drug trafficking and terrorism. Los Zetas uses Hezbollah in West Africa to launder drug profits, while Hezbollah uses the payoffs from Los Zetas to finance terrorist operations. There is speculation about an even closer link between Los Zetas and Iran, as some analysts believe that the drug

cartel may have been involved in an assassination plot against the Saudi ambassador to the United States in late 2011 (Chalk, 2012).

Narcoterrorism Controversies

Not everyone accepts the link between drugs and terrorism. Some people argue that terrorists may use drugs as a source of income, but they also use several other illegal activities to raise money. Selling drugs is only one method, and the drug problem is not caused by terrorism. Other people believe that the use of the term *narcoterrorism* is an attempt to take political advantage of the fear of terrorism. If drugs and terrorism come to mean the same thing, it will be easier to take actions against drug dealers. Critics believe that combining the drug problem with terrorism confuses two different issues.

The 9/11 Commission (2004, pp. 171–172) dismisses the idea that drugs were linked to al Qaeda's attack on New York and Washington, D.C. There is no evidence, the commission writes, that indicates bin Laden used underground drug networks or narcotics trafficking to support the September 11 attacks. The Taliban used narcotics based in Saudi Arabia and the Gulf States.

In the same article in which he explains narcoterrorism, Adams (2003) acknowledges the critics. He points to skepticism about the military and DEA assessments of Latin America. Many critics believe these organizations have overstated the problem. Other people point to misunderstandings. Terrorists are not necessarily linked to the drug trade, even when they appear to be involved with drugs. Many Arabs live in the Triborder region, and they support Hamas and Hezbollah. Just because drug trades flourish in this region does not mean that either the Arabs or the terrorist groups are associated with drugs.

David Kaplan (2003) says the financing of militant Islamic groups has very little to do with the drug trade. Based on a five-month study for *U.S. News & World Report*, Kaplan blames Saudi Arabia for funding the spread of an intolerant form of Islam. Violent intolerance, he says, spawned the rise of terrorist groups, and the sect most sympathetic to an intolerant version of Islam comes from Saudi Arabia. Charities are responsible for the bulk of terrorist financing, he believes, and the money funds radical mosques, militant schools, and Islamic centers that support the jihadist movement. Saudi money can be traced to violence in Algeria, Bosnia, Kashmir, the West Bank, Gaza, Indonesia, Somalia, and Chechnya. The spread of militant Islam is not about drugs.

Pierre-Arnaud Chouvy (2004) does not agree with the position of the French military. He argues that the term *narcoterrorism* is too vague to describe either drug traffickers or terrorists, and it does not help address either problem. The problem with drugs involves supply and demand. Western Europe and North America provide ready markets for drug use. Typical Afghan farmers fight to survive. They produce opium, the base for heroin, because it is a cash crop. Western Europe has the demand, Chouvy says, and Afghanistan has the supply. Opium production has nothing to do with terrorism. *Narcoterrorism* is a convenient term for the French government to use, appealing to public emotions and giving the police more power.

Civil libertarians are especially critical of attempts to link terrorism and drugs (Talkleft, 2003). Agreeing with Chouvy, they see the attempt to link narcotics and terrorism as a ploy by states. If terrorism were to disappear, the drug trade would remain. But if governments link drugs with terrorism, they can reinvent the meaning of crime. Drug dealers will become terrorists, and a frightened public will grant

the government expanded powers to combat drugs. In addition, courts more readily grant search warrants and wiretaps against terrorists. Civil libertarians often believe governments want to define drug pushers as narcoterrorist kingpins in an effort to increase their own power.

Michael Scheuer (2006, pp. 42–44) takes the middle ground in the debate over narcoterrorism. In an examination of Osama bin Laden, Scheuer writes that the analyses of al Qaeda's use of heroin to finance jihad range from believable to fantastic accounts. Some reports of the narcotics connection are true, some are simply asserted without evidence, and a great deal of propaganda is obviously false. Nevertheless, the narcotics trade in Afghanistan makes billions of dollars. It would be naive, Scheuer concludes, to assume that bin Laden has not been able to take advantage of some of those funds.

Emphasizing the Points



Self-Check

- > Define the two elements of narcoterrorism.
- > What arguments support the idea?
- > Why do some analysts reject the idea of narcoterrorism?

Money laundering is the process of converting the proceeds of crime into assets that can be used in the formal economy. Terrorist financing refers to illegal and legal methods of funding terrorism. For many years, analysts equated money laundering and terrorist financing, but today, the two processes are examined differently. Terrorists may also have a need to launder dirty money, such as NGO support of a militant group. Even with the shift in analysis, it is difficult to assess the effectiveness of anti-laundering and antiterrorist financing efforts. The most prominent international tools are FATF recommendations, but the effectiveness of FATF measures are subject to debate. The federal government has created financial law enforcement and intelligence units to counter money laundering and terrorist financing, and the United States and Europe have championed a host of anti-terrorist economic measures. Terrorists employ a variety of illegal methods to obtain resources and sometimes move assets in hidden networks. Terrorist financing remains complex because there is no single method or path for obtaining resources. Some analysts have concluded that one of the most lucrative ways of raising money is selling illegal drugs.

SUMMARY OF CHAPTER OBJECTIVES

- *Money laundering* is a term that was first used to describe the actions of organized crime groups. They gathered money in a variety of illegal ways and claimed that their gains were profits generated by laundromats. It is the process of converting proceeds from crime into legitimate money.
- Terrorist financing refers to the methods used to fund terrorist groups or operations. It is extremely complicated because terrorists employ a variety of legal and illegal money-making methods.
- After 9/11, governments in the United States and Europe increased anti-money laundering efforts, assuming that this action would reduce terrorist financing. Many analysts slowly recognized subtle differences. Criminals commit crime then launder the proceeds. Terrorists, by contrast, distribute funds to commit crimes.

- The United States and Europe have sponsored international efforts to combat money laundering and terrorist financing, and the UN FATF recommendations are prominent among them. Critics contend that most nations do not comply with FATF recommendations and the regulatory system is ineffective. Supporters counter by arguing that the complex system will take time to construct. They also point to increased arrest and conviction rates based on financial investigations and intelligence.
- Financial investigative and intelligence units permeate federal law enforcement agencies and the intelligence community.
- Terrorists raise funds by a number of legal and illegal methods. Illegal methods include robbery, counterfeiting, fraud, cigarette smuggling, extortion, kidnapping, and a variety of other criminal activities. Terrorists also raise money through legal operations. They divert funds to support terrorist operations. Charities and business operations are the most frequent legal activities.
- Funds are disbursed in an underground economy or through traditional money laundering activities. These include hidden money transfers such as the Hawala. They also smuggle cash, launder money, convert it to consumer products, or keep the money or goods within the organization.
- The Hawala system is based on an old method merchants used to exchange money without risking transport of actual cash. It is based on agents who exchange promissory notes. Today, some terrorists use this system to fund operations.
- The political economy of terrorism involves groups that have the ability to act autonomously in shell states and failed states. Becoming a *de facto* government power, they control the movement of money, goods, and services.
- There is a debate about the relationship between illegal drugs and terrorism. Proponents believe that terrorists use drugs to finance operations, and they use the term *narcoterrorism* to describe this activity. Opponents argue that governments use the term to increase their own power by defining common criminals as terrorists.

LOOKING INTO THE FUTURE

Rapid changes in global economic networks and exchange mechanisms suggest that traditional economic structures are fading. Private exchange systems like Bitcoin and PayPal are growing, and most economic transactions are electronic. New and changing economic systems provide opportunities for terrorists. They will also be vulnerable to terrorist attacks, especially when they are first introduced.

Forensic accounting will become crucial for effective national and international law enforcement agencies. U.S. law enforcement agencies will need to develop forensic accounting skills to face the future, but they probably will lag behind the capabilities of terrorists on the state and local levels. University trained accountants have many more lucrative employment opportunities when examining pay scales in state and local police agencies. Yet, there are alternatives. For example, partnerships with federal agencies can provide state and local forces with needed expertise. Teaching officers to recognize suspicious economic activity provides another path for future law enforcement. The U.S. Treasury Department's Suspicious Activity Report represents a step in that direction. No matter how they accomplish it, future law enforcement officers must develop the tools to thwart economic crime to deal with the economics of terrorism.

A second future need in law enforcement involves cyber skills, and these talents will be applicable to many forms of investigation and enforcement far beyond

counterterrorism. Police of the future will need to improve computer competency and form partnerships with experts to assist in investigations. The FBI has been increasing efforts in this area for the past decade, and the future will bring a greater demand for cyber skills. The future may also bring greater cooperation among forensic computing experts in law enforcement, the military's Cyber Command, and private industry.

KEY TERMS

Capone discovery, p. 53	Suppression of the	Forensic accounting, p. 64	New economy of terrorism, p. 70
Placement, p. 54	Financing of Terrorism, p. 61	Expropriation, p. 64	Failed state, p. 71
Laying, p. 54	Financial Action Task	Triborder region, p. 67	Shell state, p. 71
Integration, p. 54	Force on Money Laundering (FATF), p. 61	Globalization, p. 67	Narcoterrorism, p. 72
Black market peso exchange, p. 54		Hawala system, p. 68	