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Research Report

The Financial Flows of Terrorism and Transnational Crime

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- **How much revenue do transnational criminals yield?**
- **How do terrorists finance their activity?**
- **What means do criminals and terrorists employ to transfer money across borders?**

Summary: Yearly revenues from transnational criminal activity account for USD 1 to 1.6 trillion, and a wide variety of methods is employed to transfer those revenues across borders and launder it. The specific type of crime largely determines the choice of methods. Terrorists, for example, use both “legal” as well as illegal activity, in particular drug dealing, to raise funds, and largely employ the formal financial sector as well as physical cross-border transfers to move funds across borders. Money attributable to terrorism, however, accounts only for a tiny share of international proceedings from illicit activity.

POLICY BRIEFING

April 2012 EUSECON Policy Briefing 17

The financial flows of terrorism and transnational crime

Introduction

Anti-money laundering (AML) policies intend to disrupt the transfer of money raised by criminal activity, and efforts in the combat of the financing of terrorism (CFT) use similar sets of measures (typically termed “AML/CFT” policies) and also researchers treat money laundering and terrorist financing often together. Indeed, the two notions cannot be properly disentangled due to unclear definitions, criminals adopting methods termed “terroristic” (i.e. bombing or hostage taking) and terrorists resorting to criminal activity (i.e. drug or human trafficking) to raise funds.

With respect to financing, however, some major differences between “criminal activity” and “terrorism” are noteworthy. First, while terrorists have indiscriminate targets and ideological goals, raising profits is the primary goal of (transnational) criminals. Second, terrorists typically use a wide variety of sources of financing, depending on availability and the resistance they face. Often, the financing means are “clean” (i.e. legal) until they are used to make possible terrorist attacks.

In this Policy Briefing, we present results on [1] funding requirements and worldwide financial flows attributable to criminal activity and terrorism, [2] the sources of terrorist funds and [3] the international channels of money transfer allowing terrorists and criminal syndicates to operate internationally. Moreover, we offer some policy recommendations.

Funding requirements and financial flows

Apart from the differences between criminal syndicates and terrorist groups mentioned above, another striking difference is in the magnitude of worldwide financial flows. Terrorist attacks are remarkably “cheap” and the worldwide transaction volume attributable to terrorists thus is small compared to the volume generated by criminal syndicates. Table 1 shows the estimated “direct costs” (i.e. the cost of material used in attacks like vehicles, bomb-making components, maps or surveillance) of the most significant terrorist attacks in the last decade.

Table 1: Estimated direct costs of selected terrorist attacks

Attack	Estimated cost
London Subway 2005	~ GBP 8,000 [§]
Madrid Railways 2004	~ USD 10,000 ^{&}
Istanbul Trucks 2003	< USD 40,000 ^{&}
Jakarta Marriot Hotel 2003	~ USD 30,000 ^{&}
Bali 2002	< USD 50,000 ^{&}
WTC New York 2001	~ USD 300,000 - 500,000 ⁺
USS Cole 2000	< USD 10,000 ^{&}

Sources: [§] UKHO (2006), [&] UN (2004), ⁺ Kiser (2005)

While only for the most significant terrorist attack on the World Trade Center in New York the direct costs reach the six-digit domain, the costs for other huge attacks like the 2004 Madrid Railway bombings or the 2005 London Subway attacks are well below USD 50.000.

Thus, in raising and moving money to cover the direct costs of terrorist attacks, employing sophisticated means of concealment and covering the tracks is often not necessary.

Apart from the direct costs of executing attacks, however, running and maintaining a terrorist organization incurs “indirect costs”, which typically exceed the direct costs by far. The most significant among them are salaries and subsistence for the operative personnel and their family members, communication with parent networks and partner organizations, training, travel and logistics, advertising

and recruiting as well as providing funding for partner organizations.

The total funding requirements of and financial flows generated by terrorist organizations considerably exceed the documented direct costs of attacks, but are still low compared to the transaction volume involving money laundering.

Al-Qaeda, for example, is believed to have spent some USD 30 mn. per year prior to the attacks on September 11, 2001 on the items discussed above, like funding operations, maintaining, training, military devices, but also contributions to the Taliban, their high-level officials as well as fellow terrorist groups (US National Commission, 2004). According to the Financial Action Task Force FATF (2008), those funding requirements have not substantially changed since then, although al-Qaeda may have continually downshifted its hierarchical command-like organization and changed to a more fragmented and decentralized structure in the recent years. The financial flows generated by other terrorist organizations like Hizbullah or Hamas have been estimated to account for USD 50 mn. and USD 10 mn. on average between 1999 and 2006 (Schneider and Caruso, 2011).

Unlike terrorist syndicates, which do not specifically aim at making profits, but at pursuing ideological and political goals, raising revenue must be considered as

The direct costs of terrorist attacks are typically well below USD 50.000 a major purpose of organized transnational crime. Profits raised by pursuing illicit activities

like, for example, drug, weapon or human trafficking are typically denoted as “dirty money”, and criminals undertake considerable effort in “laundering” dirty money such that it can be officially used for procurement, investment, development and enlargement of criminal syndicates and also for engaging in further criminal activity. Impeding fundraising by criminal groups and money laundering is thus of paramount importance to states and jurisdictions.

Baker (2005) estimates that worldwide, in total between USD 1.0 and 1.6 trillion are raised by criminal activity in various forms per year. About half of it, i.e.

USD 500 to 800 per year is estimated to come from developing and transitional economies (Baker, 2005). Those countries typically have the weakest legal and administrative structures and far too often, economic and political elites who want to bring their money out of the country by any possible means.

With respect to the development over time, money laundering from organized transnational crime within 20 OECD countries has been estimated to have increased from USD 273 bn. in 1995 (1.33% of official GDP) to USD 603 bn. (or 1.74% of official GDP) in 2006. On a worldwide basis, however, the amount of money raised and laundered only by criminals involved in the drug business is estimated to be USD 600 bn. in 2006 (Schneider and Caruso, 2011).

Sources of funds

While transnational criminal syndicates make profits by carrying out illicit activities and the funding of criminal groups thus by definition stems from those illicit activities, terrorists receive funding from both illegal (i.e. by cooperating with criminal syndicates) as well as legal sources (i.e. state sponsors or charities). Al-Qaeda, for example, has been estimated to raise about one third of funding by illegal and two thirds by “legal” activities (Schneider and Caruso, 2011).

Among the “legal” sources of terrorist financing are state sponsors, private individual and corporate donors, ethnic communities and religious financing, which plays an important role in the Muslim world (Comras, 2007) as well as charities which divert legally received funding to support terrorists. Moreover, terrorists in many cases engage in legal businesses and use shell companies and banks to raise money, hide assets and protect the identity of donors.

Undoubtedly, the most important illegal source of terrorist financing is drug dealing. Peters (2009) for instance, documents in detail the strong ties between drug trafficking and al-Qaeda in Afghanistan and Pakistan. Oil smuggling and trade in arms or diamonds are other examples.

Estimates for the worldwide transfer volume stemming from illegal activities are presented in

Table 2. As can be seen, the proceeds of forging money, illegally trading arms, human trafficking as well as corruption each account for only small fractions of the criminal money turnover. Funds generated by such “criminal activity” account for some 30 to 35 percent of the global total, while illicit funds generated abusive transfer pricing, faked transactions as well as mispricing in commercial activity which is not illegal per se, is by far the largest component. It accounts for some 60 to 65 percent of the global total.

Table 2: Global flows from illicit activities, years 00/01

Global Flows	USD bn.
Drugs	120 - 200
Counterfeit goods	80 - 120
Counterfeit currency	3 - 3
Human trafficking	12 - 15
Illegal arms trade	6 - 10
Smuggling	60 - 100
Racketeering	50 - 100
Crime subtotal	331 - 549
Mispricing	200 - 250
Abusive transfer pricing	300 - 500
Fake transactions	200 - 250
Commercial subtotal	700 - 1000
Corruption	30 - 50
Total	1061 - 1599

Source: Baker (2005)

Channels of transmission

How is money raised by illicit activity transmitted across countries and thereby laundered? According to Unger (2007) and Zdankowicz (2004), the most important channels are the following:

- Wire transfers using the banking system
- Cash deposits (smurfing)
- Informal value transfer systems (i.e. Hawala)
- Physical cross-border transfer
- Business ownership
- Illegal gambling
- Over- and undervaluation of imports/exports

Which of these methods is most frequently adopted depends on the type of criminal activity and on the specific institutional arrangements present in the country where the illegal money is “earned”. For example, in the drug business, the method of “business ownership” is quite often used. Drug dealers in big cities typically earn smaller amounts of cash in a lot of different places, which they infiltrate into cash intensive operations such as restaurants. However, also cash deposits (the so-called “smurfing method”) or illegal gambling are quite often used. This obviously shows that there are a number of ways to launder money. It could thus be more efficient to put efforts in curbing criminal activities than to fight against money laundering. With respect to terrorist activity, Biersteker (2011) finds in a recent study that physical cross-border transfers as well as the formal banking system have frequently been encountered, whereas informal value transmission systems (i.e. Hawala) have, particularly in recent years, played only a minor role.

Policy recommendations:

Money laundering is on the increase although international bodies in charge of the problem (i.e. the Financial Action Task Force FATF) have issued encompassing recommendations with respect to the supervision of financial institutions and information exchange across authorities. To our point of view, more and better information exchange is key to making AML/CFT strategies more efficient and mandatory for their success. Moreover, policy makers should clearly define the main information and data requirements in order to effectively thwart money laundering and terrorist financing, and financial institutions should be trained in detecting such data. The complexity of terrorist financing and money laundering and the wide variety of techniques used by criminals requires cooperation of law enforcement and the private sector.

Credits

This EUSECON Policy Briefing was authored by Stefan Haigner, Friedrich Schneider and Florian Wakolbinger from the Johannes Kepler University Linz. The views expressed in this briefing are the authors’ alone.

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