

The Financial Front of War on Terrorism

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Abstract

This paper examines the financial front of the War on Terrorism. It argues that financial globalization in the wake of the decline of the Bretton Woods system provides multiple channels for international financial transactions. Terrorist groups make good use of this new environment to transact money to finance their causes. To weed out terrorist money, the international financial system relies on individual countries to cooperate in implementing regulatory measures, but inter-state cooperation is hampered either by some countries' opaque financial systems or by national differences in their financial systems. Thus, the financial front of the War on Terrorism is going to be a drawn-out process.

Key Words: Bretton Woods, financial transparency, Patriot Act, failed states

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The terrorist attack on New York and Washington on September 11, 2001 and the ensuing policy developments have drastically changed the landscape of international politics. Anti-terrorism has crowded out the traditional geo-political and geo-economic concerns on many countries' national agendas. This research intends to examine the recent developments in one aspect of anti-terrorism literature: Terrorism and the international financial system. This research will first describe the coming of age of an international financial system that has been characterized by "footloose capital." It then describes how terrorist organizations take advantage of this system and how sovereign states respond to this financial challenge. Lastly, this paper gives a litany of difficulties encountered by sovereign states in their attempts to rid the system of loopholes.

The Coming of Age of an Open International Financial System. The current international financial system evolved from the dealignment of the Bretton Woods System which was constructed by the United States in the immediate wake of the Second World War. At that time, the United States believed that inter-war competitive currency depreciation and, consequently, currency blocks were a major contributing factor to the war (Oye, 1985: 173-199; Simmons, 1994). It therefore coalesced with Great Britain in the Bretton Woods Conference of 1944 to construct a post-war international financial order (Gardner, 1980; Schild, 1995). This system had several characteristics. One, each country was deemed to have the right to pursue its economic goals by any means within the country's reach, including currency depreciation. Second, in order to avoid "begging-thy-neighbor" depreciation, the U.S. dollar was fixed at thirty-five dollars to one ounce of gold, and each other currency was pegged to the dollar. The "peg" could be adjusted against the dollar within one percent. Third, the current account was liberalized, but the capital account was not.

In the first decade after its inception, the Bretton Woods system worked quite well, as the United States served as the "last resort" banker for the world's financial and trading systems. But

toward the end of 1950s, however, the world found itself in the horns of a “Triffin” dilemma (Triffin, 1960). According to the economist Robert Triffin, for the system to work well, the United States would have to provide world trading and financial systems with sufficient liquidity, through large trade deficits and direct capital outflows. However, with the economic re-emergence of Western Europe and Japan, it would be more and more difficult for the dollar to maintain its parity with the currencies in those areas, as specified in the Bretton Woods system. The overhang of the dollar in the inter-bank market in Europe—the so-called Euro-dollar—would time and again be used to attack the Bretton Woods parity, thus causing fluctuation in the exchange market. The 1960s saw the United States and its main trading partners make all kinds of efforts to patch up the Bretton Woods system. In the decade, market forces, geo-politics (mainly, American involvement in Vietnam War), world economic development and policy ideas all played major roles in shaping the world’s financial system (Cohen, 1982: 457-478; Gowa, 1983; Odell, 1982). All these patch-up efforts culminated in American President Nixon’s announcement on August 15, 1971 that the dollar would not be fixed to gold, thus “suspending” the Bretton Woods system.

Since then, the world financial market has moved toward “the end of geography” (O’Brien, 1992). This end of geography has three meanings. Territorially, it means that the physical location of money is not as important as it used to be, as markets are integrated by the forces of information technology innovation and the liberalizing policies of a variety of states. Politically, it means that state authority has declined in the governance of financial markets. As Susan Strange aptly describes it, “the retreat of the state” (Strange, 1996). Conceptually, the geography of money goes beyond Westphalia-defined monetary territorial space (e.g., dollar, Euro, Yen, etc.), or the scope of classic economic geography (e.g., location of business or financial activities). Instead, it refers to “the transactional networks that undergird the world’s markets for money and capital” (Cohen, 1998: 21). All these bear

strong implications for my discussion of terrorist financing.

Terrorist Challenges and the Responses of the International Financial System. It is estimated that the operation cost of the September 11 terrorist attacks is half a million U.S. dollars, and the damage loss almost 135 billion. Thus, after the attacks federal authorities began to trace the financial lifeline of terrorist groups. Among other things, they have found that:

- to finance their activities, Osama bin Laden and the al Qaeda organization have used a complex maze of transactions, including modern offshore banking centers, shell companies, internet money laundering, and the century-old practice of hawala¹ (Ganguly, 2001);
- an international network of Islamic charity organizations, some legal, some semi-legal that donate millions of dollars to Islamic causes. Some of the donated money has been siphoned off to terrorist organizations;
- small direct contributions by bin Laden and al Qaeda sympathizers;
- legal businesses, like the import-export firm, investment company, construction company, and fruit and vegetable farm that bin Laden once owned (and may still own) in Sudan (Lesch, 2002: 203-209; McCoy & Cauchon, 2001).
- legitimate profits from banking: bin Ladin may still have

¹ **Hawala** is an underground banking system based on honor and trust. It is frequently found in the Arab world, South Asia and Southeast Asia. This system is similar to the ancient Chinese banking system called "flying money." The Arab traders adopted this practice to avoid robberies on the Silk Road. In **hawala** transaction, a customer would go to a **hawala** dealer to remit money to a recipient in another country. The sender does not identify neither himself nor the recipient. The sending **hawala** dealer will call his associate, who lives in the same city as the recipient, and give him a code. The code will then be used by the recipient to collect the money. Through time, the accounts between dealers are settled by future transactions among **hawala** dealers in the same network. Millions of dollars can be transferred across borders in a matter of hours, while no transaction records will be left.

some control over Sudan's Al Shamal Islamic Bank with his 50 dallors million of start-up capital² (CNN.com., 2001).

- criminal enterprises, ranging from small-scale extortion, kidnapping, and gambling to international drug trafficking.

While terrorist groups join crime organizations and corrupt officials to use the modern international financial system to launder their money, money-laundering per se does not appear to be able to destabilize the international monetary system or transaction security therein. The problem is instead caused by international money-laundering at law-enforcement level, as the international responses to money laundering have been quite lagging. As aforementioned, the location of money is not as important as it used to be, as money can literally be transferred almost instantaneously. Money has indeed become a systemic force in international relations (Andrews, 1994: 193-218). The decline of state authority in international financial governance only reinforces the systemic power of capital flow and states clearly need an international approach to deal with the problems associated with international money flow. The major international agency that deals with money laundering is the Financial Action Task Force (FATF) on Money Laundering. Working alongside the FATF is the Financial Stability Forum's Working Group on Offshore Financial Centers³ (Kapstein, 1994). Various countries' Financial Intelligence Units (FIU) are also engaged in financial information exchange, information analysis, and the dissemination

² Al Qaeda held a half-dozen bank accounts at Al Shamal, including one under bin Laden's name. The Al Shamal Islamic Bank, prior to the September 11 attacks, had corresponding relationships with Citibank, American Express Bank, and the Arab American Bank.

³ The Financial Stability Forum was established by the G-7, and composed of finance ministers, central bankers and supervisory officials from eleven countries with advanced financial systems. Both the IMF and the Basel Committee on Banking Supervision have representatives to the FSF. The FSF passes its data to the IMF which is nudging offshore centers toward more strict compliance with international financial standards.

of financial information analyses to domestic or regional agencies. There are now sixty-nine FIUs in the world, collectively called the Egmont Group and the U.S. Financial Crimes Enforcement Network is in charge of enhancing the cooperation and function of these units.

The FATF was established in 1989 by a G-7 summit in response to mounting concern over money laundering. In its inception, FATF membership included G-7 member states, the European Commission, and eight other countries. Now its membership includes twenty-nine countries and two international organizations. The FATF is also affiliated with FATF-style regional bodies, including the Asia/Pacific Group on Money Laundering, the Caribbean Financial Action Task Force, the Council of Europe PC-R-EV Committee, the Eastern and Southern Africa Anti-Money Laundering Group, and the Financial Action Task Force on Money Laundering in South America. Many international bodies, especially international regional banks, are also loosely connected with the FATF.

In addressing the problems of money laundering, FATF does several things. First, it sets standards to combat money laundering. It maintains a list of forty recommendations regarding the roles of the national legal system, financial system, and financial institutions in dealing with money laundering. After the September 11 attacks, FATF issued another eight recommendations to provide the basic framework for detecting and preventing the financing of terrorists. It recommends that countries ratify and implement the United Nations resolutions relating to the suppression of terrorist financing, criminalize the financing of terrorism and associated money laundering, freeze and confiscate terror assets, report suspicious transactions relating to terrorism, promote international cooperation, take measures to register alternative remittance institutions, and scrutinize transactions and wire transfers by non-profit organizations. To supplement these recommendations, FATF also provides a litany of money laundering typologies and real-life examples. For example, the *2002 FATF Report on Money*

Laundering Typologies lists seven themes of money laundering, illustrated by twenty-four case examples.⁴

The FATF has also tried to name and shame those non-cooperative countries and territories. For the first time the FATF named fifteen jurisdictions as having critical deficiencies in their anti-money laundering systems or a demonstrated unwillingness to co-operate in anti-money laundering efforts. The current name-and-shame list consists of the Cook Islands, Egypt, Grenada, Guatemala, Indonesia, Myanmar, Nauru, Nigeria, Philippines, St. Vincent and the Grenadines, and Ukraine. The FATF also recommends counter-measures to apply to non-cooperative countries and territories. In addition, the FATF monitors the development of anti-money laundering programs and legislation in a number of countries. By and large, the FATF's "recommendation" and "name names" approaches to money laundering set a clear international standard. Whether this norm will be followed by sovereign states ultimately depends upon the international politics involved.

The Financial Stability Forum's Working Group on Offshore Financial Centers is charged with considering the impact of offshore financial centers on global financial stability. Because offshore financial centers play a pivotal role in money laundering, however, the Working Group's efforts are related to the FATF mission. The Working Group has categorized the jurisdictions according to the quality of their financial supervision, cross-border cooperation, and transparency. It has identified Antigua and Barbuda, Aruba, the Bahamas, the Cayman Islands, Turks and Caicos, and Vanuatu as jurisdictions undermining the stability of the international financial system.

These two international organizations that deal with money laundering do not have the teeth to implement their recommendations. Instead, implementation depends on national

⁴ Similar money laundering typology exercises were also conducted and published in 2000 and 2001.

law enforcement agencies and financial regulatory agencies. Since the September 11 terrorist attacks, however, countries have enhanced their cooperation. For example, G-7 countries all pledged stronger surveillance of financial activities. In September 2002, the Asia-Pacific Economic Cooperation (APEC) finance ministers met in Los Cabos, Mexico, and agreed to adopt an action plan to boost their efforts to thwart terrorist financing.

In East Asia, the FATF-style regional body is the Asia/Pacific Group on Money Laundering. The APG was established in Bangkok in 1997 and Australia has played a leading role in its organization. The APG now has twenty-five members and fourteen observers that include most economies in the region. Additionally, the Asia Development Bank has, among other functions, a specific anti-money laundering mission. A glance at the ADB's recent publications shows that anti-money laundering is a major element in the bank's campaign against corruption in East Asia's financial system, but it's hard to tell how much the bank has allocated to help its member economies address money laundering. In addition, many East Asian economies have established operational financial intelligence units and have joined the Egmont Group of Financial Intelligence Units. These East Asian economies are Australia, Canada, Hong Kong (China), Japan, Republic of Korea, New Zealand, Singapore, Taiwan, Thailand, and United States. And, as mentioned above the APEC has picked up money laundering as an issue in its agenda.

Difficulties in Suppressing Terrorist Financing. In addressing the problem of terrorist financing or money laundering there are three sets of difficulties. The first has to do with sovereignty as we understand the term under the Westphalia system. It has been argued that sovereignty has been eroded in the face of international financial flows. While this is true in the sense that state regulatory power can be overwhelmed by the volume and vector of international finance,⁵ it should be noted that all offshore

⁵ Ethan Kapstein argues that regulatory agencies in individual countries can no

financial centers were created by each state's right to open such centers in the first place. This sovereign right was enhanced when international financial market integrated, deepened, and expanded in the 1970s and 1980s. Through the process of competitive emulation, states began to design ever tighter secrecy laws, open up ever easier registration for, say, virtual companies, or adopt ever more lax regulatory enforcement regimes to attract (legal and illegal) business (Palean, 1998: 625-664). Thus, when an individual country's regulatory agency (say, the U.S. Treasury Department's Foreign Terrorist Asset Tracking Center, FTATC) really wants to act on the FATF recommendations to dig out money laundering practices by terrorist groups (or some other crime organizations) in some tax havens, it is likely that FTATC's efforts will be thwarted by the legal protections the sovereign enclave provides to its customers. When some sovereign states are willing to "commercialize" their sovereignty by writing laws that legalize offshore centers (Palean, 2002: 151-176), and when other states are forced by the globalization pressure to accept that legal persons could reside in many different territories,⁶ effective enforcement of anti-money laundering measures will be exceedingly difficult (Zagaris, 2002: 45-108) to enforce.

Secondly, when many countries, especially advanced ones, try to use their financial regulatory power to attack money laundering, many failing or failed states, which are fertile ground for international terrorism, simply do not have any bureaucratic infrastructure to implement FATF measures. The problem with these states is not whether they have the will to implement any rule

longer suffice given the nature and quantity of banking and financial businesses in the modern day. Thus regulatory agencies have to work together to tackle their common problems. That is, they should form a regime like the Basle Accord to regulate banking and finance at the international level.

⁶ Forty-seven of the world's top fifty banks are operating on the Caymans. With five hundred banks in total on the islands, the Caymans are the de facto fifth largest banking center in the world.

of law regarding money laundering the problem is that they simply do not have the ability to do so (Rotberg, 2002: 127-140). While there have been some very sophisticated methods to forecast state failures like those used by the U.S. government's State Failure Task Force, the results of forecasts are not very reassuring (King & Zeng, 2001: 623-658), as country risks are indeed difficult to measure and predict (Oetzel, Richard, & Zenner, 2001:128-145). Even if failing and failed states could be identified in advance, how should other states undertake state-building in these difficult, as the current state of international relations theories and social sciences simply cannot provide any foolproof guideline (Barro, 2002: 14; Ottaway, 2002: 16-24; Mallaby, 2002: 2-7; Holm, 2001: 357-374). Thus, for example, both Ukraine and Cyprus lack any rigorous legislative and regulatory frameworks to deter money laundering. And the EU itself is very much concerned with these two countries. Many countries in the Middle East and the Gulf, as well as some countries in Southeast Asia, with varying degree of state failure, can only provide erratic and uncertain cooperation with advanced countries in stopping money laundering by terrorist groups (The International Institute for Strategic Studies, 2002: 60-69).

Thirdly, even countries with the best intentions face different political, cultural, and legal restraints in enforcing anti-money laundering measures, and examples of this abound. European countries are traditionally more sympathetic to the Palestinian cause, thus unwilling to expand the terrorist group hit list to include Hamas and Hezbollah, as the Bush Administration has. Most EU countries have declined to seize the accounts of Hamas or to deter donations to Hamas-run charities. Likewise, Saudi Arabia, United Arab Emirates, and Bahrain offered only half-hearted support for the American request to freeze terrorist-related accounts lest they risk the outrage of their domestic population. Soon after the September 11 attacks, the U.S. Congress passed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (also known as

USA Patriot Act) Act of 2001, broadening U.S. government power to enforce anti-money laundering measures (Cassella, 2002: 7-23). The U.S. government intends to invoke mutual legal- assistance treaties with EU countries to seize overseas terrorist assets or to punish those financial institutions that transact terrorist funds. Some EC countries, however, have already voiced concerns that the Patriot Act grants the U.S. government anti-money laundering powers that go beyond the letter and intent of the mutual legal-assistance treaties. The civil penalties contained in the Patriot Act may also not square with the legal systems in some EU countries (Dettmer, 2002; Shaughnessy, 2002: 25-44).

In short, to deter and suppress terrorist financing, closing off money laundering, which has been called the “biggest loophole in the free-market system” (Baker, 1999: 29-46) is essential. It is still not clear if the job will be done, but if the international community does not do it, the problem will only get worse and worse.

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反恐戰爭的金融前線

何思因

摘 要

本文討論九一一之後反恐戰爭的金融層面。自布列敦森林體制在一九七〇年代開始逐漸崩毀，國際金融體系為國際資金流動打開了方便之門。恐怖組織就利用這個國際金融環境將錢移往世界各地，從事恐怖活動。真要潰除恐怖組織的財務力量，各國必須合作。但是因為一些開發中國家的金融體系不透明，開發中國家對國際金融的規範也有不同的看法，反恐戰爭的金融前線、戰線和戰事都將拖得很長。

關鍵詞：布列敦森林體制、金融透明度、提供反恐所需政策工具法案、治理不足的國家