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The broader impact of terrorism on financial stability
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The immediate results of terrorism, seen so graphically in pictures of mourning families and twisted metal, represent only one side of their cost; the wider loss of revenue and investment can devastate a local economy and undermine the financial stability of a country, or even a region. And on top of the direct and indirect costs of terrorist attacks are the costs incurred in trying to prevent them. Whether immediate and local, such as the reinforcement of security at key installations, or longer term and broader, such as the implementation of regulations designed to attack the financing of terrorism, these costs add considerably to the overall financial impact of terrorism.

Terrorism and counter-terrorism represent a constant cycle of action and reaction. The inescapable asymmetry of terrorism allows terrorists to concentrate their resources far more effectively than their counter-terrorist opponents. Terrorists can ensure a direct correlation between expenditure and impact, while those whose job it is to stop them have to guard against a range of possible attacks and protect many different targets without knowing whether or not they are truly at risk.

It costs terrorists little to cause major loss of life and widespread fear and disruption. According to an official British Government report, the attack on the London transport system in July 2005, in which 52 random people were killed, cost the terrorists around \$15,000; an insignificant figure compared to the costs that resulted from it (\$750m in lost tourist revenues alone by some estimates).

The sums spent on dealing with terrorist incidents, and more especially the cost of preventing new ones, has been on a steady upward curve since the attacks in the United States on 11 September 2001. The United Kingdom estimates that its annual spending on counter-terrorism will reach close to \$4 billion by 2008, double what it was before the 2001 attacks. Usama Bin Laden, referring to these attacks just before the November 2004 US Presidential elections, boasted that while they had cost Al-Qaida \$500,000, they had cost the United States \$500 billion. He may well be right. In so far as they can be calculated, the immediate costs of the attack in terms of loss of life, property and

production were put at \$100 billion, and the indirect costs, in terms of other lost revenues, new protective measures and the refocus of government policy, will be many times higher. President Bush requested a \$42.7 billion budget allocation for the Department of Homeland Security alone for 2007, much of it to finance counter-terrorist initiatives, compared with \$19.5 billion for 2002; and this figure takes no account of the huge accumulated costs of the campaigns in Afghanistan and Iraq.

The global nature of Al-Qaida-related terrorism, which encourages attacks against its opponents wherever they are located, gives States no option but to develop and pay for some sort of a counter terrorist policy. While these costs may not threaten the financial stability of countries such as the US, countries with much smaller economies must also take measures to protect their people and critical infrastructure from attack. Furthermore they may face the indirect costs of terrorism even when the attacks happen far away. The indirect consequences of terrorism can affect such things as inward investment, tourism, communications, energy prices, distribution costs, property values and consumer confidence. For example, the attack on the huge Abqaiq oil installation in Saudi Arabia in February 2006, even though unsuccessful, caused an immediate \$2 spike in the price of oil; the Bali attacks in October 2002 and October 2005 not only affected tourism in Indonesia - the loss of revenue after the 2002 attack equalled 2.3% of GDP- but also throughout South East Asia. One can only imagine the widespread economic consequences of a 'dirty bomb' (one containing radioactive, chemical or biological substances) detonating in an urban environment – which is a known objective of Al-Qaida.

Terrorists are, of course, well aware of the broader consequences of their attacks, and plan them accordingly. The attacks on the World Trade Centre in 1993 and 2001 were deliberately aimed at an iconic symbol of American economic power, and in two recent statements Aiman Al-Zawahiri, regarded as the second-in-command of al-Qaida, made the economic objectives of the terrorist campaign explicit. In March 2006 he said that 'the first front for Al-Qaida was to inflict losses on the Crusader West, in particular on its economic being'; in September he added 'the focus must be on their [the West's] economic interests, in particular to stop their stealing the oil of the Muslims'.

While States can judge how much they should spend on local counter-terrorist protection depending on other calls on their money and their assessment of the risk of attack, they have less control when it comes to implementing international counter-terrorism initiatives, such as introduced by the United Nations, or to introducing multi-laterally agreed standards, such as recommended by the Financial Action Task Force (FATF).

The United Nations Security Council first introduced mandatory sanctions against the Taliban and Al-Qaida in Afghanistan in 1999 and since then it has broadened the regime to apply to a list of designated individuals, groups and entities associated with the Taliban and Al-Qaida without any geographic restriction. This global sanctions regime requires all Member States of the United Nations to impose an assets freeze, an arms embargo and a travel ban on those named on the Security Council list. All States must have legislation and mechanisms in place that allow them to apply the sanctions within their jurisdiction,

or risk whatever penalty the Security Council might impose for a failure to do so. The Security Council also expects all States to achieve minimum standards of implementation, given that terrorists will look for ways to evade the regime by exploiting its weakest links.

Similarly, the nine FATF Special Recommendations on Terrorist Financing propose further unavoidable expense for States. These recommendations, eight of which were drawn up in the immediate aftermath of the 2001 attacks in the United States, were supported by the Security Council in resolution 1617 (2005), which 'strongly urges all Member States to implement the comprehensive international standards' embodied in them. To do so effectively may be a task beyond the capacity of most States, and this may be why, in terms of practical application, the recommendations have been largely ignored or put in the 'too difficult' tray. But the pressure on States to make some effort to adopt the recommendations has increased since they were introduced in 2001, and it is conceivable that non-compliant States might find it harder to conduct international financial transactions if they did nothing at all. But apart from the difficulties and expense of introducing and implementing the necessary legislation associated with the nine special recommendations, there are less direct costs involved.

In particular, special recommendation VI, concerning Alternative Remittance, could have a real consequence for the financial stability of certain States if implemented. The recommendation proposes that all persons or entities 'that provide a service for the transmission of money or value' 'should be licensed or registered and subject to all the FATF Recommendations that apply to banks and non-bank financial institutions'. It is hard to imagine how this might be done without raising costs to a level that would either force providers underground or force the millions of migrant workers and others who currently use these systems to find cheaper alternatives. Many States rely heavily on overseas remittances for their financial viability, and without money from relatives abroad many families would become destitute. World Bank estimates (and they can only be estimates because of the lack of records) put the amount of money remitted worldwide in 2004 as between \$200 billion and \$300 billion, second only in total to the amount of foreign direct investment and far more than official development assistance. While a good portion of this money will have passed through banks and other registered financial institutions, many migrant workers are from countries without a developed retail banking system and in any case will be attracted by the comparative speed, simplicity and low cost of alternative and informal systems. A strict implementation of this measure might therefore have consequences quite different from the intended ones, causing difficulties and hardships that might actually promote conditions conducive to terrorism.

As well as international agreements, certain national counter-terrorist regulations may cause financial difficulties for would-be trading partners. For example, the Container Security Initiative (CSI), introduced by the United States Bureau of Customs and Border Protection in 2002, was designed to increase security for container cargo shipped to the United States by extending the 'zone of security outward so that American borders are the last line of defense, not the first'. About 90% of world trade is transported by container, and almost half of all imports to the US (by value), amounting to 9.6 million

containers in 2004, arrives in this way. The CSI certainly does not intend to make it harder for ports in developing countries to trade with the US if they do not have the 'regular, direct, and substantial container traffic to ports in the United States' that qualifies them to join the initiative; nor does the CSI intend to add prohibitive costs to ports that may have the traffic but lack the necessary screening equipment or other required security measures. But inevitably, exporters who use one of the 50 ports that were part of the CSI programme as of October 2006 will have an advantage over those that do not. One of the advertised benefits of CSI is that 'the integrity of the shipment[s] is better ensured by using pre-arrival information and non-intrusive inspection equipment at foreign port locations, thus expediting their clearance upon arrival in the United States'. This may therefore oblige ports in developing countries to up their security budgets or face a possible loss of competitiveness.

If the additional costs of counter-terrorism since September 2001 have been off-set by a reduction in terrorist attacks (and the costs they incur), then the money spent may have done more to promote financial stability than to undermine it. But there appears to be no end in sight to the threat of terrorist attacks, nor to the measures taken to prevent them, and this continuing upward spiral of action and reaction sucks all States into its vortex. Pressure will increase for more resources for law enforcement and intelligence work, greater protection for key sites and other vulnerable targets, better screening at border entry points, more public information campaigns and more effective examination of financial transactions and the movement of value in both the private and the public sector.

There is no demonstrable correlation between poverty and terrorism, and economic development may not be a key factor in preventing the growth of terrorism in any particular country. For example the Kingdom of Saudi Arabia was spending \$5.5 billion a year on security in 2003 and no doubt spends even more today, but it still faces a hard core of terrorist supporters; and the British Home Secretary acknowledges facing a threat that is 'enduring – the struggle will be long and wide and deep'. But the poorer and less developed a country, and the less effective its government, the more likely that terrorists will try to find recruits there. International initiatives should not force States to divert money from education and other key development budgets unless the counter-terrorist benefits are obvious and proportionate to their cost.

Much has been written about the direct and indirect economic consequences of terrorist attacks, and there is some understanding of the direct and indirect costs of the measures taken to prevent them, but particularly in the febrile atmosphere following the 2001 attacks in the US, international bodies have paid too little attention to the cumulative financial burden of terrorism and counter-terrorism on the developing world. It would be a hard and long journey for many States to reach the standards expected of them, even with unlimited outside assistance, and as the demands of counter-terrorism increase, many States may decide that they no longer see the effort worth the gain. There is little prospect of defeating global terrorism without the willing engagement of all members of the international community and it is perhaps time to review what is being demanded of States in terms of cost and effect. This may best be achieved through a close partnership

between those people who have an understanding of financial and economic issues and those who have an understanding of terrorism.

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