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ECONOMIC TERROR: MARKET MANIFESTATIONS OF TERROR ATTACKS

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In the recent past, we have paid painful witness to terrorism's capacity to harm the United States financial sector. While the September 11, 2001 terrorist attacks on the World Trade Center and attempt on the Pentagon (9/11) are perhaps most commonly viewed as unprecedented *physical* terror attacks, they also exemplify an economic attack.[1] Besides the immeasurable value of lives lost in the attack, there were also grave financial costs. The price of terrorism is something that is becoming more of an issue in a largely connected financial market. Where once, we worried about finance being used to support terrorism, there is now a clearer concern about the financial impact of terrorist attacks. The question is: if terrorists have noticed this, could they use this information to "double-down" on the damage they cause?

A. FINANCING OF TERROR

The direct property damages of 9/11 are estimated at over $20 billion.[2] The abstract cost, or *opportunity* cost, is estimated at around $1.7 billion for September alone in the U.S. Exchanges and a 2.7% drop in the world's economic growth rate.[3] The stock market itself did not open on 9/11, nor did it do so for an entire week thereafter. The World Trade Center had communication and transactional systems that the markets needed. The markets, though, were not closed simply because of the physical destruction of systems, but they were also affected by the destruction of confidence in the market itself. This issue was not just one that only affected the U.S. Instead, the 9/11 attacks rippled

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1 See Paul Krugman, The Costs of Terrorism: What Do We Know? 2, 1–2, 4–6 (Dec. 13, 2004) (unpublished manuscript, available online), http://www.l20.org/libraryitem.php?libraryId=9 (describing economic costs as being comprised of "direct economic damage" to buildings, infrastructure, and lives; the additional spending by the government to fight terrorism; and the cost of businesses, government, and individuals choosing economically safer but less productive activities or plans than they otherwise would have).

2 *See* Krugman, at 2.

3 *See* Dick K. Nanto, *9/11 Terrorism: Global Economic Costs*, CRS Report for Congress, 3 (October 5, 2004) (asserting the opportunity cost without including the $53 billion the U.S. spent on combating terrorism which can also be considered an opportunity cost); *cf.* Krugman, *supra* note 1, at 6 ("[There is a] net cost to the world economy [when] people and businesses whose decisions are affected by terrorism choose alternatives that would otherwise be regarded as less desirable . . . . [W]hen a tourist decides to hear country music in Branson rather than [go to Broadway,] the cost to the U.S. economy is the extra he or she would have been willing to pay to see the metropolitan production.")

internationally, impacting the confidence of investors in world markets.[4] Fortunately, the market recovered fairly quickly.[5] But the aftereffects stayed within the markets.[6]

Under the Bush Administration, the United States took decisive steps to prevent this from happening again. Banks and citizens saw business practices change, as the USA Patriot Act curbed the use of financial markets and instruments to proliferate terrorism.[7] Title III of the Patriot Act specifically sought to curb money laundering by terrorist organizations.[8] The 9/11 terrorist group spent somewhere between $400,000 and $500,000 on their vicious plot and financed operations by "us[ing] the anonymity provided by the huge international and domestic financial system to move and store their money through a series of unremarkable transactions."[9] The bulk of the U.S. Department of Homeland Security's (DHS) focus has been, in the past few years, to curb such terrorist funding by using existing policy and legal tools. This has been of extreme importance as the 9/11 plot only took $500,000 of the annual budget of Al Qaeda, which had previously been estimated at $30 million.[10] Stopping these funding mechanisms, however, has proven a difficult task.

Terrorist financing, although compared to money laundering, is actually a unique financial crime. Money laundering involves dirty money[11] being "cleaned" or finding a way to legally route it through the financial system without detection. Terrorist financing though, often involves the use of *clean* money for lethal purposes.[12] While some terrorist funding sources do rely on traditional criminal activities, such as extortion, narcotics trafficking, or counterfeiting, others rely on more modern and legitimate models. These include donations or funds skimmed from donations, commercial enterprises, and even state-sponsored funding. The Department of the Treasury's Financial Crimes En-

4 Amy Zalman, *Economic Impact of Terrorism and the September 11 Attacks: Direct Economic Impact Was Less Than Feared, But Defense Spending Rose by 1/3*, About.com, http://terrorism.about.com/od/issuestrends/a/ EconomicImpact.htm (last visited Sept. 3, 2010).

5 *See* R. Barry Johnston & Oana M. Nedelescu, "The Impact of Terrorism on Financial Markets" 7(International Monetary Fund) (2005) ("[O]nce the initial shock passed, both markets [measured by the S&P 500 and the Dow Jones EURO STOXX Index] bounced back within weeks to pre-September 11 levels and generally continued to rise thereafter").

6 *Cf.* Krugman *supra* note 1, 6 (arguing that distortion costs resulted from travelers changing plans due to heightened fear of a terrorist attack); *see also Nanto supra* note 3, 2 (stating that 279,000 travel and tourism jobs were lost after the 9/11 attacks).

7 *See* International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001, Pub. L. No. 107-56, § 301, 115 Stat. 272, 295-297 (codified at 31 U.S.C. 5301, 31 U.S.C. 5311, and under various other titles and sections).

8 § 302(b)(1).

9 *See* Nat'l Comm'n on Terrorist Attacks upon the United States, Monograph on Terrorist Financing, app. A, at 131, 133-139, *available at* http://www.9-11commission.gov/staff_statements/911_TerrFin_Monograph.pdf [hereinafter Monograph] (listing the different forms the currency went through: wires, traveler's checks, and overseas accounts through American and foreign bank correspondent accounts, although no American was found by the report to have assisted in any of these dealings).

10 *Id.* at 144 (estimating the budget of Al Qaeda during the period of the 9/11 plot at $30 million).

11 Dirty money is normally used as proceeds from criminal activity as differentiated from terrorist financing which usually involves the reverse: using clean funds for "dirty" purposes.

12 *Terrorism: Growing Wahhabi Influence in the United States: Hearing Before the S. Comm. on the Judiciary*, 108th Cong. __ (2003) (testimony of David Aufhauser, General Counsel, U.S. Treasury Dep't), *available at* http://www.au.af.mil/au/awc/awcgate/congress/terrorist_financing.htm [hereinafter Aufhauser].

forcement Network (FinCEN), the FBI's Financial Crimes Section (FCS), the Department of State, the Department of Justice, and other Federal agencies have been using both their own tools and the powers conferred by the Patriot Act to create more transparency and accountability in financial institutions around the world. Indeed, the Financial Action Task Force (FATF), an intergovernmental body established by the G7 in 1989, is co-chaired by the U.S. Treasury and has worked toward setting specific global transactions tracking standards, as one way to make sure terrorists do not take advantage of fractured regulatory environments. For instance, subsidiaries held by international bank holding companies, like Citibank or Bank of America, were identified as potential targets for such abuses.[13] These agencies have also taken steps to shut down hawalas,[14] which were heavily used for short-term and "anonymous" financing.[15] Some organizations who offered these services were reclassified by law as MSBs,[16] which now subjected them to money laundering and terrorist financing regulations.

How have these operations succeeded thus far? In a three-year span (2001-2003), 281 persons or entities were designated as terrorist organizations or as entities supporting terrorism; through broad international cooperation, assets of over $137 million belonging to these groups were frozen.[17] While this does seem to be a large amount, Al Qaeda paid the Taliban $20 million a year, in *tithe alone*, for safe harbor within Afghanistan.[18] The Taliban, who tax opium producers, are rumored to have stockpiled more than 10,000 tons of poppy seeds (used to manufacture opium and heroin) themselves; this amounts to a street value of billions of U.S. dollars. Such a figure calls into question any "accomplishment" in freezing a mere $137 million.[19] Thus terrorist funding is still a major issue. Case in point: the U.S. Treasury Department stated that it was overwhelmed by the amount of

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13 *See* MONOGRAPH, *supra* note 9, app. A, at 134–135, 138–140 (identifying Citibank and Bank of America as the prime international banks used by the 9/11 terrorists).

14 *See* U.S. Dep't of the Treasury, *Key Issues: Hawala & Alternative Remittance Systems,* U.S. DEP'T OF THE TREASURY, http://www.ustreas.gov/offices/enforcement/key-issues/hawala/ (last visited Sept. 3, 2010) (defining hawala as "a fast and cost-effective method for the worldwide remittance of money or value, particularly for persons who may be outside the reach of the traditional financial sector"); *see also* AUFHAUSER, *supra* note 8 (using the same definition).

15 *But cf.* MONOGRAPH, *supra* note X, at 139 ("[there] is no evidence to suggest that the hijackers used hawala . . . to send money to the United States [for the 9/11 attacks]").

16 *See* IRS, *Money Services Business (MSB) Information Center*, IRS.GOV, http://www.irs.gov/businesses/small/article/0,,id=185491,00.html (last visited Sept. 3, 2010) (defining money service businesses (MSBs) those businesses that offer "check cashing, money orders, traveler's checks, money transfers, currency dealing or exchange, and stored value products" and stating that they are subject to certain Bank Secrecy Act requirements). These requirements include the following: Registering with the federal government. Reporting cash transactions of more than $10,000. Reporting suspicious activity. And having an anti-money laundering compliance program. *See id.*; *see also* AUFHAUSER, *supra* note 8 (noting that over 14,000 money service businesses had already complied with registration by 2003).

17 *See* AUFHAUSER, *supra* note 8.

18 *Id.*

19 Simon Wilson, *Where Do al-Qaeda and the Taliban Get Their Money?*, MONEY WEEK, Oct. 23, 2009, http://www.moneyweek.com/news-and-charts/economics/where-al-qaeda-and-the-taliban-get-their-money-45809.aspx (pointing out that even if foreign financing were cut off, taxes on stockpiled drugs could be a long-term source of financing). *But see id.* (admitting that the while the Taliban is estimated to make $70-100 million a year from taxing drugs, it also received $106 million in foreign donations in 2009).

suspicious activity reports received in 2001 alone—when reports rose 350%.[20] If governments are having problems with the enforcement of current laws and have only managed to freeze a fraction of targeted assets, where does the U.S. stand in relation to accomplishing its goals of stopping the funding of terrorism?

The terrorist finance networks themselves branch out through other networks in multiple nations. To deal with these networks within its own borders, the U.S. government needs to improve coordination between the private and public sectors. Thus, unlike the U.K. system where U.K. banks spend $430 million per year on anti-terror and anti-money laundering measures alone, an American system should be implemented that uses the resources jointly and more efficiently. This would lighten the impact upon the private sector, and government agencies would be less overwhelmed. This same model would apply to the U.S. government when it works in conjunction with other States, which themselves have weaker banking regulatory systems susceptible to exploitation by terrorist groups. Again, a clear model needs to be established within U.S. borders, before the U.S. begins to coordinate enforcement efforts globally. As the U.S looks to harmonize enforcement work of its different agencies, some major priorities include: (1) setting issue-based parameters for the jurisdiction of each agency, (2) whether to freeze individual assets or network assets, and (3) devoting attention not only to inter-agency matters, but also to public and private harmonization in the fight against terrorist funding.

B. Money for "Financial Terror" Instead of Funding Terror

The 9/11 Commission investigated the role of trading in the time leading up to 9/11, to see if any transactions were strategically placed in anticipation of a potential market reaction to the attacks. The Commission particularly scrutinized the use of shorts, options, and various other derivatives, such as insurance contracts. They found that no investments had been made in anticipation or with knowledge of the attacks. Many people had been clamoring over the possibility that terrorists were "doubling-down" on their attacks by trading on markets in the knowledge that that their attacks would create market change in a predictable pattern.[21] Still, even thought the Commission concluded there was no evidence, one must remember the words of astronomer Carl Sagan that "absence of evidence is not [the] evidence of absence."[22]

While federal investigators did not find any evidence of suspect patterns in financial markets, they were considering the possibility that terrorist groups were manipulating securities markets to fund their operations. In 2007, the U.S. Treasury, jointly with the DHS, created a Banking and Fi-

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20 *See* Eben Kaplan, *Tracking Down Terrorist Financing*, Council on Foreign Relations, Apr. 4, 2006, http://www.cfr.org/publication/10356/tracking_down_terrorist_financing.html.

21 *See Profiting from Disaster: When the Stocks Fell, $5 Million Profit Was Made*, CBS Evening News, Sept. 19, 2001, http://www.cbsnews.com/stories/2001/09/19/eveningnews/main311834.shtml; David Musser, *World Trade Center Terrorist Profiteering: Largest Terrorist Financial Attack in American History*, suite101.com, Mar. 7, 2010, http://www.suite101.com/content/world-trade-center-terrorist-profiteering-a210334.

22 *Dr. Carl Sagan Quotes*, ThinkExist.com, http://thinkexist.com/quotation/absence_of_evidence_is_not_evidence_of_absence/154055.html (last visited Sept. 4, 2010).

nance Sector Strategy plan to identify key infrastructural points within the financial system in order to prioritize and coordinate protection among various federal agencies and private sector entities.[23] In February of 2007, India's national security advisor reported that a Sri Lanka-based terrorist organization had set up shell companies to raise funds through Indian securities markets.[24] The CIA has briefed other U.S. agencies, such as the Securities and Exchange Commission (SEC) on organizations that have been increasingly active in foreign securities markets. While the SEC has already undertaken a large burden regulating its domain within the domestic market, it is now being briefed on international terrorist financing through securities markets over which it has no jurisdiction. While the Patriot Act and FinCEN regulation require U.S. securities firms to follow anti-money laundering laws, the system's fragmented nature (distributed among brokers and dealers) could allow for some less-than-honest persons and entities to look the other way on transactions without realizing that they are inadvertently aiding terrorist fundraising. This vulnerability is due in no small part to the incentive-based commission process of the securities industry.

As the current economic climate has reminded us, regulators tend to lag behind the private sector, because the marketplace can improve its products and mechanisms at a much faster rate.[25] The IMF has conducted a study showing that the financial markets can be victim, perpetrator, or instrumentality in a terrorist attack.[26] The study found that in 1998, terrorist targets started to change from military to civilian targets.[27] Businesses as targets have, in fact, been favored by terrorists as well. While many businesses have not seen market effects as strong as some experts have warned, some scholars have argued that were it not for the Federal Reserve's "accommodative policy," the effects of 9/11 would have been even more devastating.[28] The study goes on to indicate that on a macro-level, a financial industry with diversified portfolios, regardless of natural or non-natural influences can create a safer system; however, at the micro-level, direct attacks on financial markets will still affect the markets and this underlines the importance of having a contingency plan in place.[29]

While terrorist groups have yet to directly attack the financial and securities markets, a coor-

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23 *See generally* DEP'T OF HOMELAND SECURITY & U.S. DEP'T OF TREASURY, BANKING AND FINANCE: CRITICAL INFRASTRUCTURE AND KEY RESOURCES SECTOR SPECIFIC PLAN AS INPUT TO THE NATIONAL INFRASTRUCTURE PROTECTION PLAN 1 (2007), *available at* http://www.dhs.gov/xlibrary/assets/nipp-ssp-banking.pdf.

24 *See* M. K. Narayanan, India Nat'l Sec. Adviser, Speech at the 43rd Munich Conference on Security Policy (Feb. 11, 2007).

25 *Cf. The Commodity Futures Modernization Act of 2000: Hearing on S. 2697 Before the S. Comm. on Agric., Nutrition & Forestry and the Comm. on Banking, Hous. & Urban Affairs*, 106th Cong. (2000) (statement of Arthur Levitt, Chairman, U.S. Sec. & Exch. Comm'n) (stating that for the SEC to assert jurisdiction over products or instruments, it needs to meet, usually time-tested, criteria that show these products or instruments are under the SEC's jurisdiction).

26 *See generally* Johnston & Nedelescu, *supra* note 5, at 3(arguing that banks can be harmed directly or indirectly; used to set up and support terrorism; and used, without knowledge, to channel terrorist funds).

27 *See* Johnston & Nedelescu, *supra* note 5, at 3. *See generally* Tilman Brück & Bengt-Arne Wickström, *The Economic Consequences of Terror: Guest Editors' Introduction*, 20 EUR. J. POL. ECON. 293-300 (2004);

28 *Id.* at 7–8 (citing Andrew H. Chen & Thomas F. Siems, *The Effects of Terrorism on Global Capital Markets*, 20 EURO. J. POL. ECON 349–366 (2004).

29 *Id* at 8–9.

dinated attack with the use of large amounts of money being strategically placed[30] would not be altogether without precedent. Financial markets have been "influenced" by large movements of money as well as threats of large movements of money. Take, for example, the Suez Canal Crisis in 1956.[31] When Egyptian President Gamal Abdel Nasser nationalized the Suez Canal and drove British, French, and Israeli troops to the verge of war with Egypt, the United States dissuaded the British government by threatening to sell a commodity. What was the commodity? British pounds. A sell-off of U.S.-held debt would have led to a crash in the British markets due to the massive depreciation of the pound. Pressured by this economic threat and the U.N.'s condemnation of a war, the Suez Canal Crisis was eventually settled peacefully.

Moving forward sixteen years to 1972 and the Nixon Administration-backed fall of the Allende government, one may see another form of such pressure.[32] Nixon exerted financial pressure against the Allende government by restricting international economic credit to Chile. This exacerbated a pre-existing problem, as Allende's currency policy for financing certain domestic projects had caused commercial banks to downgrade Chile's credit ratings.[33] In the current century, one may consider more the recent examples from 2006, 2009, and 2010 of the Chinese government exerting their financial muscle against the United States. In 2006, it became an attractive political talking point to decry the loss of negotiating leverage due to the indebtedness of the United States to China.[34] In 2009, after Bush's "TARP I" and Obama's "TARP II" stimulus programs, which created very flat yields on U.S. GDP and a higher deficit, China publicly expressed concern about its investment in U.S. government debt. In 2010, when the U.S. sold weapons to Taiwan, Chinese military officials proposed boosting defense spending and selling U.S. bonds to punish Washington.[35]

These examples of pressure brought by State actors arguably border on financial "terror" when used on other State actors. Take the private sector into consideration: credit default swap (CDS)

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30 This can be either through a conventional attack and strategic "short" selling on assets that would be affected by an attack or strategic movements of money utilized as the main terrorist "attack".

31 While terrorism is typically (if not always) a non-State act; a non-State actor could effectually do more ambitious projects either in conjunction with a terrorist-supporting State or with enough financial support and/or resources.

32 *See* Staff of S. Select Comm. to Study Governmental Operations With Respect to Intelligence Activities, 94th Cong., Covert Action in Chile 1963-1973, at 26-38 (Comm. Print 1975), *available at* http://www.fas.org/irp/ops/policy/church-chile.htm (describing economic pressures placed on the Allende government by the Nixon Administration).

33 *Id.*

34 *See, e.g.*, Teddy Davis, *Debt Weakens U.S. Hand on China: Democratic Sen. Evan Bayh Sounds Alarm on Debt and Dependency*, April 20, 2006, ABC NEWS, http://abcnews.go.com/Politics/International/story?id=1867118&page=1 (reporting that Democratic Senator Bayh was among those stating that the U.S. must pay close attention to its debt dependency with China).

35 Chris Buckley, *China PLA Officers Urge Economic Punch Against U.S.*, Reuters, Feb. 9, 2010, http://www.reuters.com/article/idUSTRE6183KG20100209 (noting, however, that the "People's Liberation Army . . . plays no role in setting policy for China's foreign exchange holdings" and that such a "move could alarm markets and damage the value of China's own holdings.").

contracts sold by AIG brought AIG down in 2008.[36] Most of the CDS contracts sold to banks were sold by the very investment banks that had created the underlying assets. As many of these underlying assets began to fail, AIG could not refinance its debt, as its credit ratings were downgraded due to declining liquidity from the CDS payouts. While there was technically no foul play, this company was brought down because of these CDS contracts. The same could have been done by a fund with enough money. If enough CDS contracts were bought against a company, its credit ratings would be brought down; this, in turn, would make it harder for a firm to refinance its debt and create new liquidity. When a company goes illiquid, it goes bankrupt and the CDS contracts earn money.[37]

A terrorist organization with the backing of deep-pockets or a State actor wanting to attack the U.S. financial markets, perhaps as a reprisal against disagreeable U.S. policies, *could* follow a similar approach. By selling CDS contracts on an entity, it starts the cyclical time clock of a company's downfall, if enough contracts are sold on the said company. This idea is very similar to short-selling a company when a panic occurs in the market. While this type of pressure has not been executed by a government, let alone by a non-state actor, it presents a dangerous possibility for vulnerable financial markets. The DOJ, the Treasury Department, the SEC, and the DHS have already begun recruiting and creating offices specializing in the intersection of finance and counterterrorism.[38] What has yet to be carried out, but should be sanctioned, is a multi-agency study to explore the likelihood, timeline, and potential actors involved in carrying out such acts through complex financial instruments.

For this reason, financial terrorism and the funding of financial terrorism have not only become intrinsically linked issues but they could be a complement to future attacks: whether a non-State actor works with a State-actor, whether a traditional terrorist attack is "doubled-down" by strategically placed financial derivatives, or whether the attack is a complex financial attack implemented through the simple positioning of mass financial resources. With the interconnectedness of world

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36 *See generally* Kenneth Vereen, Jr., *How Credit Default Swaps Brought Down Wall Street*, 2 Gatton Student Res. Publication 1, 1-16. (Spring 2010), *available at* http://gatton.uky.edu/GSRP/Downloads/Issues/Spring2010/How%20Credit%20Default%20Swaps%20Brought%20Down%20Wall%20Street.pdf. CDS or credit default swaps are basically insurance contracts on debts. They work almost like short-selling on a company, except for the fact that they are separate insurance contracts based on an underlying obligation by the firm. The buyer of a CDS does not have to be in privity with the debt obligator.

37 When short-term or long-term financing becomes too expensive to fund a company's operational costs, the company will need to file bankruptcy when they have no cash on hand to cover present expenses.

38 *See Biometric Identification: Before the H. Appropriations Comm., Subcomm. on Homeland Sec.*, 101th Cong. (2009) (statements of Kathleen Kraninger, Deputy Assistant Sec'y for Policy, Screening Coordination & Robert A. Mocny, Director, US-VISIT, Nat'l Prot. & Programs Directorate), *available at* http://www.dhs.gov/ynews/testimony/testimony_1237563811984.shtm; *see also* Dep't of the Treasury, Treasury Forfeiture Fund: Accountability Report 1 (2003), *available at* http://www.ustreas.gov/offices/enforcement/teoaf/publications/03-annual-report.pdf (updating the inter-operation work of the fund to coordinate the multi-task operation with the new DHS agency involvement with the 2002 Homeland Security Act); Dep't of Justice, *President Obama Establishes Interagency Financial Fraud Enforcement Task Force*, U.S. Dep't of Justice, Nov. 17, 2009, *available at* http://www.justice.gov/opa/pr/2009/November/09-opa-1243.html (establishing a Financial Fraud Task force consisting of senior-level officials from the Department of the Treasury, the Department of Justice, the Department of Housing and Urban Development, the Securities Exchange of Commission, and other agencies).

markets, an attack on the United States would not even have to be directed at U.S. markets to have a profound effect. Imagine the possibility of a knowledgeable Iran taking a negative position on a company that is about to be a target of a conventional terrorist attack by Hezbollah; or the Chinese government, for example, selling of U.S. debt in an uncontrolled manner in a illegitimate fashion to hurt the U.S. economy.[39] U.S. agencies need to renew focus on terrorists manipulating the financial system in order to calculate the danger and study which law and regulations are in place to deter such manipulation. The United States has long had the executive power of declaring "bank holidays" to stop panics, but is that enough? An even more important question is: what other measures could the U.S. take? The Treasury has multiple agencies dealing in the financial field; how are these and other agencies at the SEC, DOJ, and HUD coordinated by the DHS? These issues need to be answered from an *ex ante*, rather than *ex post*, perspective.

39 While a Chinese attempt to sell a substantial amount of U.S. debt would impact the U.S., it would also likely hurt the Chinese. Such a maneuver would harm the China's position among countries friendly to the U.S., and China would not likely recoup their heavy investments in full.