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We are delighted to introduce our Winter 2015 issue!

The Fletcher Security Review: Managed and edited by students at the Fletcher School of Law and Diplomacy, we build on the Fletcher School's strong traditions of combining scholarship with practice, fostering close interdisciplinary collaboration, and acting as a vehicle for groundbreaking discussion of international security. We believe that by leveraging these strengths – seeking input from established and up-and-coming scholars, practitioners, and analysts from around the world on topics deserving of greater attention – we can promote genuinely unique ways of looking at the future of security.

Each issue of the Review is centered around a broad theme – in this issue, we tackle “Money & War.” Money influences every aspect of warfare, conventional or unconventional. No nation-state military, insurgent group, terrorist network, trans-national criminal organization, or hybrid actor can be understood, or countered, without knowing where the money is coming from – as well as where, and how, it gets spent. Evolutions and revolutions in financial tools and practices quickly translate to transformations in military affairs, and some cases, vice versa.

Of course, this issue, and the Fletcher Security Review as a whole is not the product of one person but the collective achievement of our entire group. Many worked long hours to produce content across the four editorial sections – policy, history, current affairs, book reviews and interviews – as well as our new blog and our design and business teams. We thank the advisory board members – Richard Shultz, Robert Pfaltzgraff and James Stavridis – for their steadfast support and Dean Gerard Sheehan for his unwavering encouragement.

Thanks for joining us!

SARAH DETZNER
Editor-in-Chief

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High profile crises can lead us to forget that maritime security is an everyday event; it is about enabling safe transit. Each step within the maritime transport of goods has security challenges and considerations. At the same time, the continued stability and effectiveness of maritime trade is itself a broader security matter of importance to consumers, businesses, and governments. With the “weaponization of finance” maritime trade will play a central role in economic actions being taken out of geopolitical concerns.

The State of the Two Sudans:

Q&A *with* James Copnall



A prolific writer and reporter, James Copnall was the BBC's Sudan correspondent from 2009-12 and covered South Sudan's independence, the Darfur war, rebellions, and clashes between both the Sudans. He has also reported from over twenty other African nations. His latest book, *A Poisonous Thorn in Our Hearts: Sudan and South Sudan's Bitter and Incomplete Divorce* deals extensively with the conflict engulfing the Sudans from various perspectives. Earlier this year, he sat down with the Fletcher Security Review to give some perspective on recent developments.

FSR: There have been lots of theories stating that economics have been the main [driver of division between Sudan and South Sudan] because of the presence of natural resources in South Sudan. What do you think about that?

Copnall: Obviously resources and the economy are an important part of [the division] in the sense that people outside South Sudan felt that it could potentially be a viable country...because it had something like 350,000 barrels a day of [oil] production and reserves. And certainly in the history of the conflict, the civil war in what was then the united Sudan, there was fighting over oil, which was a key part of the conflict. Human rights abuses were committed over oil. But I think if you ask ordinary South Sudanese, their desire for independence was not really about oil as such. It was about a feeling of being treated as second-class citizens. Of course, [they felt this way partly because] their area hadn't been developed and the resources in that area, including oil, hadn't benefited them and their region. The economy is part of it, but there was also a desire to have their own country...

FSR: Even with large reserves of natural resources, how is South Sudan unable to manage [economic issues]?

Copnall: First of all, it is probably the least developed place on Earth, partly because of conflict, partly because of neglect. At independence it had really next to nothing. So, although there are oil reserves and that brought money into the economy, it was starting from a very low base, which meant that people were

“Problems between the two countries still exist, but because of the economic crisis, both countries realized that they needed each other to a certain extent, to survive.”

also illiterate, uneducated, and the oil alone was never going to be enough [to jumpstart economic development]. It was going to run out, so there was a need to diversify and move toward agriculture and other fields. But that's difficult at the moment because the infrastructure is so bad...

Also, it is a very bloated military state [with] maybe 300,000, maybe more, people in uniform receiving salaries. Lots of money went towards [military salaries] and some of their top commanders creamed off some of that money. Ordinary people didn't benefit. Also, all the money and all the resources were concentrated in the center in the capital, Juba, rather than going out throughout the country. So that, in a way, followed the [centralized] Sudanese pattern, the Sudanese model, that the South Sudanese had fought against.

In the period after independence, oil in particular became very controversial. South Sudan is dependent on Sudan in the sense that, to export its oil it has to use the pipelines and the refineries, the export terminal that Sudan has. It wants to build a new pipeline, but that will cost billions of dollars and will take a long time. So there's economic dependence. Because there was no agreement over how much Sudan should be paid for this, there was a growing row, and Sudan started taking (or stealing) South Sudan's oil in lieu of payment and South Sudan took the rather extraordinary decision to shut down its own oil production on January 20th, 2012. Now that was 98% of government revenue. It meant that GDP didn't slow - it cratered. The economy shrank massively. Austerity measures came into place. In general the military was paid but not always. Civil

servants' salaries came late and any money that would have gone towards developing the country just simply wasn't available anymore. This was a direct result of an ongoing dispute with Sudan and that 15-month austerity period was extremely damaging for the Sudanese economy.

FSR: What is the situation between the two countries now? Will these problems force South Sudan to improve its negotiations with Sudan?

Copnall: That's happened already, actually. In September 2012 there were nine agreements signed in Addis Ababa. These [agreements] were implemented over the course of the following year. By August-September 2013 they were properly implemented. The oil was switched on again and there was an agreement as to how much South Sudan should pay for transporting this oil through Sudan's oil infrastructure. And that was a key deal. Another one was on trade because Sudan had closed its borders [to trade from South Sudan]. Actually in the border areas trade is much more important than oil because people hadn't seen the benefits of oil. But once the border from Sudan was closed, the price of sorghum went up because you couldn't get it from nearby Sudan and it was very expensive to [import from elsewhere in East Africa], particularly during the rainy season. So trade was a vital agreement, almost as important as oil. But essentially the political elites in Juba and Khartoum came to the decision that they needed the oil to flow to pump money into the economies of both countries. So there is a certain economic mutual dependency.

FSR: Some scholars have argued that the out of control growth of the security sector is gobbling up all of South Sudan's budget, which obviously mirrors what happened in Khartoum to a certain extent. Do you agree that that's what's happening? And do you think there is any way to stop it?

Copnall: It's part of a very militarized system in South Sudan where political legitimacy comes from your military accomplishments. And therefore what you did during the war is what gives you legitimacy to govern, not actually your democratic credentials. Luka Biong with the SPLM [Sudan People's Liberation Movement] has written about the "liberation curse" and this is something that affects a lot of liberation movements. That is, the qualities that you have that make you a good liberation fighter are not necessarily the ones that make you a good democratic leader. I think that's part of the problem. So this growth of the military state is in part self-preservation, in part following the Sudanese model, and in part a sense of entitlement from people who spent most of their lives in the bush fighting and wanted something in return.

I think it's interesting that there's a level of self-criticism that has come into South Sudanese society and the South Sudanese political elite since the problems of the last year or so since the conflict. So a couple of years ago no one in the SPLM or the SPLA [Sudan People's Liberation Army] wanted to hear any criticism whatsoever. And now criticism is rife. Everyone ac-

cepts that the post-independence period has been a failure politically and people blame different people or different factors, but everyone agrees that it has been a failure. And that does create an opportunity for reigning in a little bit the excesses of the militarized state, albeit with limited resources—much of the oil has been sold off in advance to deal with current crises. There are problems paying soldiers as it is and it's a dangerous path that has been taken. One hope in this whole awful process of the last few months [of] the conflict is that the military could be divorced from politics and the politicians would have effective oversight and control over the military...It would be possible to reign in this tendency, but I think actually it's unlikely. What is likely to happen is some sort of power-sharing deal where militant people from both sides will have to be compensated for giving up fighting.

FSR: Does South Sudan have a viable government right now? In other words, is it stable?

Copnall: In a very simple way it is not stable at all because you have a civil war and rebels fighting in 10 states and threatening a couple of the other states. That war came about largely because of tensions within the governing party. What has been important in the post-independence period has been the dominance of the single party, the SPLM, with no space for the opposition. The conflicts within the SPLM have been the ones to follow, and they have been the ones that have torn the country apart. The conflicts within the SPLM now become a countrywide problem because of the conflict that they brought. You have an increasingly authoritarian government in Juba and the rebels also controlling areas and putting up some sort of administration in their areas. Ultimately you might get a power-sharing deal, but that is going to bring about the same sorts of problems again, including very strong personalities. I think one of the problems is the constitution, which gives too much power to the president. He is able to sack elected state governors, for example. That is one of the issues. Again, there is a possibility for change through an interim peace agreement that may well emerge out of peace talks in Addis Ababa and a new constitution-writing process. There is a big debate in South Sudan now about federalism, which is a key demand of the rebels, but also of the people in the greater equatorial region. Federalism can be an answer to the country's problems.

FSR: Without the strong personality of a leader like John Garang, does South Sudan tear itself apart or come to some sort of uneasy power-sharing arrangement? Or is federalism the answer? Is that a way to stabilize it?

Copnall: Well, John Garang was a visionary, but he was also a divisive man in a way. If you look at the history of the rebellion, you had...huge tensions within the liberation struggle. And when Garang died in 2005, most South Sudanese forces were under the control of Paulino Matip and were opposed to the SPLA. It was Salva Kiir who signed the Juba Declaration with Paulino Matip in January 2006 to bring all the South Sudanese troops essentially under one banner. So actually it wasn't Ga-

rang who brought about that unity...Kiir, although perceived by other South Sudanese leaders when he took over for Garang as weak, did become known for his big tent strategy of bringing people in.

I think it's healthy that soon South Sudan will have a debate about the merits of federalism. There's a danger, I think, though some argue for it, of ethnic federalism... South Sudan's biggest problem right now other than the militarized society is the lack of national unity and national identity other than one in opposition to Khartoum. When the problems from Khartoum diminish, those internal fissures become ever more apparent. So if you had an ethnic federal system, how are you actually going to bring the nation together?

FSR: What role do young people play in shaping politics in Sudan and South Sudan?

Copnall: ...My sense among a lot of young Sudanese is that they are disillusioned with politics... So there are people who are extremely passionate either for or against Bashir, but I think the majority—unless the economy completely disintegrates - will remain aloof from [politics] and carry on trying to get along with their lives. I remember once covering a protest in Khartoum and there were maybe 200 people there and they were very angry and they were chased away by the police and some were arrested and some were beaten and so on. And then a little later I was driving through Khartoum and I saw several thousand people on the streets and they were celebrating the victory of their football team. And that was what brought lots of people into the streets. So I think many people are simply disillusioned with politics. They feel there is not going to be any change, so why risk their lives? Now of course, with big economic shocks there might be changes, but I don't think that the traditional opposition has the power to move people the way it did. And if you look at the traditional opposition leaders, the main leader of the opposition [Sadiq al-Mahdi], who was first prime minister in the 1960s. Now that is astonishing. That means he was prime minister before the vast majority of Sudanese were even born. I just got back from South Sudan and one of the things I found quite depressing was the number of young people who are prepared for conflict and want it to continue really until their chosen leader comes to power or remains unopposed in power.

My feeling about South Sudan is that people have experienced so much trauma over decades that everyone has known conflict for so long that it is a normal part of life and not an extraordinary part of life. I was at a school the other day and we were talking about some of my experiences at the school's journalism club. We were talking about being in an area as it was bombed, which has happened a couple of times to me. And we asked whether other people had similar experiences and more than half of the people in the room—30 or 40 people—raised their hands about having run away from bombs. It's generations of people who have suffered that kind of violence. So I think there is a willingness to entertain the possibility of more violence because it is normal. It is what happens and I think this is one of

the difficult cycles in South Sudan that's almost impossible to break...

FSR: Do you see ethnic lines becoming stronger in South Sudan?

Copnall: Sadly, yes. I think the conflict when it began in December was often wrongly described as an ethnic war and I don't think it was. I think it was a war that came about through politics and ambitions and rivalry and so on. But politicians in South Sudan have ethnic constituencies. In the beginning of the conflict in particular, lots of Nuer—Riek Machar's ethnic group—were killed in Juba. Hundreds of civilians were killed by gunmen often on the basis of their ethnicity. And that pushed a lot of Nuer both in the army and not in the army to take up weapons and fight on behalf of Riek Machar, but really in revenge for what happened in Juba. They and government troops have committed a lot of massacres since on civilians, often on ethnic grounds. Ethnic tensions have been exacerbated and that is something the country will have to deal with. It wasn't an ethnic war when it started and it's not entirely ethnic now, but there is an ethnic dimension to it that is difficult to ignore.

FSR: Which countries are most affected by the refugee influx that has resulted from fighting in Sudan and South Sudan?

Copnall: Kenya and Ethiopia historically are [the main destinations for refugees from Sudan and South Sudan]. It's a strange thing right now because in Sudan you have [more than 100,000] South Sudanese fleeing the conflict. Meanwhile, 200,000 or 300,000 from Sudan are fleeing into South Sudan because of the conflict in South Kordofan and Blue Nile. This new fighting in South Sudan has displaced about 1.8 million people. Most of them are internally displaced and around 400,000 have gone mainly to Kenya and to different countries, including Ethiopia. Obviously that places a burden on those countries. There's disruption to the economy. There are also lots of Kenyan, Ugandan, Ethiopian and Eritrean businessmen in South Sudan. South Sudan maybe plays a relatively small part in their economies, but it is significant too and the leaders are definitely concerned about that.

FSR: Is there any trans-border ethnic overlap that can be inflamed later on?

Copnall: Historically you've seen that quite a lot. One example would be the Zaghawa who are in Darfur. Chadian President Idriss Déby is a Zaghawa and many of the Darfur rebels are Zaghawa too. And at one point he was supporting them and particularly JEM, the Justice and Equality Movement, against Khartoum and Khartoum was supporting rebels against Chad. So you had rebels against N'Djamena and Khartoum in 2008 that were essentially sponsored by the rival states and that was in part due to those cross border [ethnic] ties, which you see a lot of in Darfur. In South Sudan you have the Azande, who are in Central African Republic and DRC [Democratic Republic of Congo] and Western Equatoria [State] in South Sudan. Some-

one... was declaring an independent Azande state. I don't think it has any significance now, but who knows what could happen in the future. If you look also in the east of Sudan to the ethnic groups who cross over the Eritrean border they are significant to the security of both countries too. So yes, [ethnicity] can play a very big role.

FSR: Is China supporting the Sudanese and South Sudanese governments?

Copnall: China supported Khartoum and was willing to invest heavily in infrastructure, including oil infrastructure and dams and roads in Sudan. When South Sudan seceded, [China's] position changed. It went from almost unconditional support of Khartoum to aiming for a more balanced relationship between Juba and Khartoum because Juba had the oil. And that was obviously a strategic win for Juba compared to China's previous position. [China] would certainly like a better relationship between the two Sudans, which has partially happened. But [it also wants] a peaceful South Sudan so that the oil continues to flow and its oil supplies would not be affected...China in general is not that open and vocal about its position, but it's clearly fed up with the continuing conflict and is working at least behind the scenes to try to resolve it.

FSR: How have Egypt's relationships with Sudan and South Sudan evolved?

Copnall: There have been some quite difficult times between Egypt and Sudan. Sudan's significance to Egypt [largely revolves around] the Nile, which is essential for Egyptian national survival. Even [when the relationship between Khartoum and Cairo was difficult], Sudan more or less always played ball on the Nile. And that's more or less changed a little bit with the Ethiopian dam [Grand Ethiopian Renaissance Dam] because Sudan has realized it can benefit from electricity created by the dam. So its position has changed a little bit and that is annoying Cairo. But I was in Cairo recently and the feeling is that Sisi's Egypt has been extremely negative, obviously, against the Muslim Brotherhood—against Islamists—and it disapproves of the government in Sudan, which is Islamist at least in name. That is causing tensions between Khartoum and Cairo.

FSR: What role does international aid play [in driving or preventing the conflict]?

Copnall: Corruption is one thing and it's a real problem. And the other thing is that South Sudanese fighting forces and forces around the world have used resources—including resources meant for humanitarian aid—as a tool of war. I'm pretty sure it's happening now. Both sides want humanitarian aid going into their areas because they will be able to feed their soldiers. [This] is an unavoidable price [of] humanitarian aid. They can try to control it and reduce it, but ultimately if you want to feed hungry people you have to accept some of that money is going elsewhere. Corruption is maybe a little bit different. There are ways in which money can be given to local organizations or

given directly so [aid agencies] can avoid large-scale corruption. But again, you probably have to accept the fact that it is such a terribly corrupt society that some of that donor money is going to be stolen. Are you prepared to accept the consequences of that knowing that the majority of it isn't [being stolen]?

FSR: What did you hope to convey through the title of your book "A Poisonous Thorn in Our Hearts"?

Copnall: Poisons have antidotes, I guess. What I wanted to convey by that title essentially was the difficulties in the relationship between the two and the damage that they did to each other in the post-independence period. I think the relationship did get better and can get better. It will never be a very good relationship as long as the current political elites are in power in both countries because they fought against each other for most of their lives and that mistrust will always be there. There is a sort of acknowledgement by both sides that they need each other economically, but they are never going to love each other. There was an interesting point made in the book that [the Sudanese and South Sudanese] are the only ones who can make peace because the subsequent generations don't know each other... Subsequent generations of South Sudanese leaders won't speak Arabic and they won't have gone to the same schools, won't have fought in the same battles and so maybe it's up to this generation to make peace. But I think it's more likely that it will be the next generation who will [improve relations].

**Editorial clarifications indicated in brackets throughout.*





Opposite page: A young man has the flag of the Republic of South Sudan painted on his face to celebrate the birth of the new nation in Juba, Sudan (Paul Banks, United Nations). Above: Final security arrangements for the Justice and Equality Movement start with the assessment and registration of equipment and weapons in El Fasher, North Darfur (Hamid Abdulsalam, UNAMID). Below: Soldiers of the SPLA redeploy to form a new Joint Integrated Unit battalion with the Sudan Armed Forces , under the agreement of the Abyei road map in Manyang, Sudan (Tim McKulka, United Nations).



The “Political Marketplace” & The Roots of Persistent Conflict

An Interview with Alex de Waal

As the Executive Director of the World Peace Foundation, Professor Alex de Waal is considered one of the foremost experts on Sudan and the Horn of Africa. His scholarly work and practice has also probed humanitarian crisis and response, human rights, HIV/AIDS and governance in Africa, and conflict and peace-building. In 1988, he received a D.Phil. in social anthropology at Nuffield College, Oxford for his thesis on the 1984-5 Darfur famine in Sudan. He was the first chairman of the Mines Advisory Group at the beginning of the International Campaign to Ban Landmines. He set up two independent human rights organizations, African Rights (1993) and Justice Africa (1999), focusing respectively on documenting human rights abuses and developing policies to respond to human rights crises, notably in Rwanda, Somalia and Sudan. From 1997 to 2001, he focused on avenues to peaceful resolution of the second Sudanese Civil War. In 2001, he returned to his work on health in Africa, writing on the intersection of HIV/AIDS, poverty and governance, and initiated the Commission on HIV/AIDS and Governance in Africa. During 2005-06, deWaal was seconded to the African Union mediation team for Darfur and from 2009-11 served as senior adviser to the African Union High-Level Implementation Panel for Sudan. He was on the list of Foreign Policy’s 100 most influential public intellectuals in 2008 and Atlantic Monthly’s 27 “brave thinkers” in 2009.



say that politics is all about money, because that would imply that politics is all about personal enrichment. My analysis, particularly about the Horn of Africa, but [with] wider resonance and implications in the rest of the world, is that—the way the politics and economics function in these societies—politics and business are fused. In order to be a businessperson, you also need to be a politician. In order to run a business, one needs to have certain skills, aptitudes, and capabilities to network and analyze that politicians have. Similarly, to be a politician, one needs to have the abilities that a businessman has. Most politicians in conflict zones, be they dictators, or

military leaders, or others who have risen to the top, tend to run their political careers as if they are businesses.

In Sudan the political vernacular has two concepts. It’s almost a pun—[there is] the “political marketplace”, and the “political budget” which is also [referred to] as “political box” or “pocket.” And these two interact in the way that political budget involves the funds that a politician has that he can dispense for whatever purposes he likes... Typically [they are used] either for developing a security apparatus that is loyal to them personally or for patronage payouts, for renting provisional allegiance of clients. It is in the sphere of payouts that one has to deal with the political marketplace, in which the intermediaries demand certain amount of money to maintain allegiance. In a place like Darfur, where the political system is extremely fragmented, you cannot be a serious political player unless you have an armed group. The allegiance of that group will be worth a certain amount of money and the price of that allegiance can go up or down depending on the market conditions.

FSR: So are you saying that the politics in the conflict situation are driven by broader economic problems?

de Waal: The politics and economics fuse. If you take a small,

“Political Marketplace” of Conflict

FSR: In your latest book and in other endeavors, you’ve tried to explain much of the conflict we see in parts of Africa, and perhaps elsewhere, as a product of the “political marketplace.” Can you explain what you mean by the term?

de Waal: My starting point is that business is politics and politics is business. It would be incorrect and a simplification to

poor country that has an open economy, these countries find it extremely difficult to compete in the global economic order for products. Some changes in the small factors like interest rates, or policy changes in countries like the United States of America (USA) or China can have a huge impact on [smaller countries'] economies, which can be snuffed out in a moment. The key task of a businessman is to manage those contingencies, and in such situations one cannot think of long-term goals: it's all about managing short-term implications.

In those countries, the most profitable sectors are going to be those where we get rent, either from minerals or from government, and so the business sector will congregate around the government, as it is the key dispenser and regulator of the resources. The [finances] that are available to businesses and political budgets become one and the same. Moreover, with political globalization, with global commodities markets, foreign aid flows, and, importantly, the global security apparatus, the most important source of revenue [for small, economically weak countries] can come from the security cooperation with advanced countries like the USA, France or others. Hence, the political marketplace has two aspects—it is full of the rent-seekers, and it is globally integrated. [Due to regional and global integration], it's no longer the case that what happens in one country is insulated from what happens in the other countries...

FSR: In these situations, how do you think the political marketplace interacts with and responds to global pressures and international intervention?

de Waal: International intervention usually involves both resources and troops. It is the resources that tend to drive the political marketplace in a conflict zone, and international troops, particularly peacekeepers, cannot do much in the absence of a political agreement. The idea of sending United Nations or international troops into a country to enforce peace rarely works. The key for the dynamics and the prospects for resolution of conflict always remain in the political sphere. If the political sphere is constituted by the control over these external rental resources, and if the external intervention is not designed with an understanding of how that political marketplace functions, then it is likely to be co-opted into the existing system and the resources will be utilized by the political entrepreneurs and political business managers for their own reasons.

FSR: How often are there successful monopolists, leaders who gain enough power to shut down the marketplace and push out all other bidders?

de Waal: There will be political leaders who seek monopolies, but the extent to which they can achieve monopoly or not has a big impact on the dynamics of a country. In some countries, like Chad, political leaders tend to gain significant monopoly over the resources, even if it is not absolute.

However, in the countries like Somalia, the efforts of the international community to help its leaders to establish a monopo-

ly—through aid and peacekeeping force—is still not very effective. [This is] primarily because the major source of earnings in Somalia—telecommunications sector and expat remittances—has not been captured by the current political elite. As a result of this, the barriers for new political entities to enter the Somali political sphere are very low, allowing political entrepreneurs to enter the market and establish themselves as legitimate players with certain influence, making the price of loyalty quite high in the Somali political market. Due to this situation, for those in Somali government a majority of time, skill and resources are occupied in the effort of managing the dynamics of the political marketplace rather than on building durable institutions. In my view, the state-building exercise in Somalia is swimming against the tide of political marketplace.

FSR: In that case, should we be hoping for and encouraging stronger monopolies in order to create stronger states?

de Waal: Creating monopolies and autocracies have two typical problems. One is the succession problem - the exit options. The barriers to exit for someone who achieves near monopoly or dominance in the political market can be very high, in that the succession or handing over of the monopoly to someone else could be very difficult for the simple reason that the intended successor may lack the skills to maintain the succession. The other problem is the regional one, where neighboring states could have vested interests in the internal affairs of a state. This issue often comes up due to the lack of territorially-bounded monopolies. These problems force us to think...if it is possible to build a state at all because in the globalized economy, most of the trends in the smaller open economies [are] towards dismantling the state structure and not building them. Each time we see an autocrat who is trying to regulate the system and there is a transition towards something more democratic, what we actually see is not a transition towards regular democracy but towards a political marketplace.

FSR: Can you reflect on the efforts of Ethiopian leader Meles Zenawi in swimming [against] this tide [given the fact that Ethiopia became stronger as a state while neighboring states were weakening]?

de Waal: Meles Zenawi and the Ethiopian transition are very good examples of this as he theorized and understood this problem very clearly. He thought that democracy is the nemesis of the political marketplace in Africa. He, however, was not successful in achieving this in Ethiopia before he died, but what he achieved, in particularly the last 10 years, was to exercise such a tight control over the allocation of revenue and rent - mainly policy and aid rents - in order to grow the economy very fast.

Due to this, Ethiopia was getting an annual economic growth of eight to ten percent. If this had been sustained over the next ten years, it would have brought that country into the bracket of middle-income countries. Meles Zenawi hoped that a growth in such terms would lead to a transformation of the state. The weakness of this strategy was pursuing it with a single mind. The



UNAMID troops from Tanzania, deployed in Khor Abeche, South Darfur, conduct a routine patrol on 1 July 2014 in Karbab village, where the community reported threats by other tribes. UNAMID reinforced the number of patrols in villages around Khor Abeche, where on March 22 over 300 heavily armed men set fire to dozens of shelters in a camp for displaced people and stole livestock belonging to the residents (Albert González Farran, UNAMID).

tight control exerted over the allocation of resources changed the nature of government, and the ruling party in particular, into rigid entities, something like purely implementation agencies. The major difficulty [was that] nobody else could run that system as effectively as Zenawi did, giving rise to a succession problem. Zenawi was a political businessman, and because of his specific business skills, he was trying to achieve political goals by using business strategies. The other side of this issue is that if someone tries to enter political markets with purely political motives - like establishing an Islamic State or rooting-out corruption - and do not take the business aspect seriously, they will not succeed.

FSR: Can you elaborate on this point?

de Waal: This issue is highlighted by many case studies. For example, Al-Qaeda, according to its own documents, found that it could not establish itself in Northern Africa as a viable entity due to the lack of strong presence in businesses. I believe that having strong business skills is a prerequisite for anyone to successfully establish themselves in the political sphere.

The Changing Face of Peacekeeping

FSR: What do you think would be a better way [than current strategies of the international community] to deal with persistent conflicts across the world?

de Waal: In the societies engulfed in conflicts, one can see that monopolies can create a certain sense of calm, even if it is for an

extended period of time—say 10 years. But to achieve durable peace, one has to address the cause for the turbulence itself. Uncertainty is a common factor even in developed capitalist societies. There is constant innovation going on and people do not know when the housing rates will go up or interest rates will fall, among other things. But one has to ensure that the creative destruction of capitalism does not turn violent, killing people or destroying livelihoods. The answers for this problem lay not at the local or country level but at the global level. The two key aspects that fuel violence are oil and international security co-operation. The counter-terrorism cooperation that is extended to the peacekeeping operations is actually a driver of instability in these systems.

FSR: What makes intervener countries target particular regimes?

de Waal: I think it is in very few cases that the United States or European nations are interested in regime change. They are much more interested in the suppression of militant insurgencies. There is also this agenda of prevention of atrocities. So the major issue is to stop the involvement of people who have vested interests in such countries. Then multilateral peacekeeping, or rather peace-enforcing operations, become operations with several added agendas. They are peacekeepers because of their international mandate, not because they achieve peace.

FSR: Is peacekeeping itself a continuation of conflict?

de Waal: It is becoming so. The classical model of peacekeeping is where UN troops drawn from faraway countries go to monitor and possibly enforce an agreement already reached among

the parties involved. But in the new model of peacekeeping is neighboring states - which have vested interests - sending their troops.

This is also a result of the involvement of countries like the United States and France who want to fight and defeat certain elements like Al-Qaeda and Al-Shabaab, and others. And the only [international] troops that are willing to participate in such operations are Western special forces, who are very confident that they will not have to suffer the casualties, or those who have vested interests, like neighboring countries. When you have forces that have considerable capacity to wage a protracted war, peacekeeping merges with war itself. In such situations, the political budget is derived from defense and military budget.

FSR: To what extent do you believe that the major donor countries are aware of these issues? Particularly when in the last few years there was a criticism that the United States was “played” by a lot of countries when it comes to [getting U.S. money for anything that could be called] a counter-terrorism campaign. Was that in fact accidental? And do you think it is the appropriate policy to avoid a recurrence of such a situation in the future?

de Waal: At this moment, I don't think we have clear policy responses and I think policymakers understand pieces of this. But I have not seen anywhere to integrate this into one analysis and think where is this going and what kind of response is required. What I hope to do in my book is to provide that discussion because I don't have an answer either. Giving a policy framework will be difficult because I think we are not at a stage where we have the type of analysis involved to be able to make sensible policies at the moment.

The Future - Likely Trends, Necessary Changes, and Other Drivers of Conflict

FSR: You mentioned that political actors are often forced to evolve into political entrepreneurs. Do you think this process is restricted to conflict zones alone?

de Waal: I think we need to see the organized violence or recurrent violence as not solely a feature of conflict between recognized political and military forces but as a feature of these systems as a whole, as a part of their governance module. So even in a country that does not have recognized large-scale violence within its boundaries, these features occur. One of the paradoxes we have is that on one hand state-building is getting harder ... and large-scale violence is actually declining, but on the other hand, the violence that tends to continue is more intractable. So some 30-40 years ago you could have a peace agreement between warring states and you knew that the war is over. Now you have a lot of peace agreements and the wars and attended violence continues. This is also because, in the past, the peace agreements also tended to be the drafts of the constitution and it would go into legal and constitutional form and they would be more or less respected by all. Now a peace agreement is like a bargain in the market and [it] will be only good as long as those particular market conditions exist. And to preserve an earlier peace agreement, the next one will be called as an implementation matrix, as a road map to implement the agreement. You can have 10 agreements and the agreements are not a solution to the conflict, they are an extra layer of the governing of the conflict itself.

FSR: How concerned are you that this model is spreading? Do



On 29 March 2011, peacekeepers from Thailand are on patrol at the camp for refugees from Center African Republic (CAR) in Muhkjar . This classical model of peacekeeping, where troops from distant countries come “to monitor and enforce an agreement,” is being replaced by a new model where troops are being sourced from neighboring countries. De Waal believes that that involvement of international forces with enormous capacity has merged peacekeeping with war, the political budget with the military budget (Albert Gonzalez Farran / UNAMID).

you think this can be contained at all?

de Waal: I don't know if it is spreading across the world. But I think there is a good reason that this model is spreading. If you see across the conflict-ridden areas—Afghanistan, Syria, Yemen—the trend is indicating towards this, and when the trend is towards one way, that gives a reason to believe that this is a bigger phenomenon. The small open economies may be the ones that are affected by this trend directly now, but others may be following the same trend, which can be a cause of concern.

FSR: You identified the threat of alternate political structures being incompatible with the conflict-ridden areas. In such a situation, what should the international community do? Should they disengage from the situation and allow [these areas] to evolve on their own?

de Waal: Disengagement is not possible; it shouldn't be on the table as an option at all. There are different forms of engagement and this is where we need to know more. If you take politics as business, seriously as a proposition, then you will not ask a businessperson to go into a new market without having thoroughly understood the nature of that market.

In the same way there are no off-the-shelf recommendations, or even framework for, let's say, responding to Islamic State. We need to understand the political market price of that region and I suspect that the actors in the conflict zones understand it really quite well. If you were to listen to the discussions of the intelligence and security chiefs they would be talking this language. But their objectives tend to be short-term security management. When we move from short-term security management, the long-term issue stabilization of the region is often neglected as the models we are drawing upon are failing us. We should take seriously the actual practices of those who manage these systems and try and build a response based on that system.

FSR: When you say that the other systems we are [relying] upon are not helping the situation, do you mean that those systems are not [taking into account] the business aspects of the conflicts involved?

de Waal: Yes, but it is not just the role of money that is involved. Take, for example, a lot of attention has been given to the sources of finance to the Islamic State. People have been discussing about the ways it is generating money by way of taking hostages, or receiving money from Qatar, or by liquidating the assets in the region. But I have not seen anyone look at the other side of the story, which is expenditure. What is its political budget? What is its security budget? To what extent is it actually producing public goods? These questions matter because this particular group is not functioning like a regular terrorist group, mainly because it controls territory and is functioning as a territorial insurgent. A territorial insurgent has to provide public goods. Without understanding these aspects it will be difficult to analyze the problem itself.

FSR: You advocate that the people who have access to the conflict zones – those who live in those areas – to study their problems. Considering this as a dangerous proposition for those involved in the conflict itself, what steps would you suggest to bridge the problem of communications breakdown between those involved in conflict and the outsiders who want to resolve it?

de Waal: If you want to find out how a regular market works, you will not get the best answer by going and asking the most successful businessman in that market for the deepest secrets of their success. But we know enough about the markets to be able to teach business management and administration. So I don't see any reason why we cannot progress further than where we are in understanding the nature of conflicts.

FSR: You are also involved in another project about global arms industry. Can you to share some information about that with our readers?

de Waal: Arms spending and defense budget is one of the key elements of the political budgeting and corruption. Corruption and political budgeting are overlapping categories. There was an estimate that global arms trade was responsible for 40 percent of the corruption in the international trade itself. This is primarily a result of the unusual production function of the arms industry itself. Manufacturers across the world, with the exception of the United States [whose military provides large enough market to support a domestic arms industry], can ... cover the costs only by charging exorbitant rates or by exporting the arms, so there is an inbuilt incentive to pay bribes to encourage exports to the countries that would be purchasing those arms. And from the point of purchasing countries, those bribes can play very important role and will go into the political budgets

FSR: The board of World Peace Foundation votes every year on the issue of whether world peace has been achieved or not. How is it looking this year? And also [are] the states that are capable of [advocating for world peace] ... identifying and preparing for the threats ahead?

de Waal: The trustees of the foundation take a vote on whether world peace has been achieved or not every November, and for last 100 years the vote has always been that it has not been achieved. I suspect it will remain so for a long time to come. Having said that, if our founder, Edwin Ginn, were alive, according to his three elements – presence of the League of Nations, the World Court, and disarmament – he would have said that his objectives were met to a large extent. But we can never rule out the possibility of future conflicts, which might spring up at any time. The threats to world peace come from elsewhere. It is no more the territorial conquest that threatens the world peace, but the military spending of the major powers are still locked in the past. They still need to make provisions for emerging threats like global warming, threats of infectious diseases, terrorism, and cyber threats. They still build submarines and aircraft carriers.

**Editorial clarifications indicated in brackets throughout.*

Accountability for Armed Contractors

BY **Dr. Ian Ralby**

On 16 September 2007, the accountability of private armed contractors became a global concern. A team of armed guards from the US company Blackwater Worldwide, operating on a US State Department contract, opened fire that day in Baghdad's Nisur Square, killing seventeen Iraqi civilians and injuring an additional twenty. It took more than seven years before four of the individuals responsible were ultimately convicted of either first degree murder or voluntary manslaughter by a jury in a U.S. Federal District Court. A fifth member of the Blackwater team had previously pleaded guilty to manslaughter.¹ The initial lack of consequences and the slow speed of justice provided the watchful world with strong evidence that armed contractors operate in a zone of legal twilight, devoid of accountability.

The rise of private armed contracting was one of the most distinctive operational developments of the wars in Iraq and Afghanistan. Erik Prince, founder of Blackwater, famously stated: "Our corporate goal is to do for the national security apparatus what FedEx did to the postal service."² Throughout both conflicts, the hiring policies of several Western governments, particularly those of the United States, helped Blackwater and numerous other companies move toward that goal. By December 2008, for example, 69% of the United States' total force in Af-

ghanistan was comprised of private contractors, roughly 15% of which were armed.³ While there are no reliable statistics on the size of the global private armed security industry, there is little doubt that it has grown and contracted with the surge and decline of Western engagement in armed conflict. New conflicts on the horizon, however, suggest the possibility of a resurgence of the industry, reigniting concerns about accountability.

The proliferation of private armed security companies has coincided with a proliferation of initiatives aimed at developing accountability for the industry. Numerous codes, standards, mechanisms and proposals – developed by governments, international organizations, civil society groups, private companies, trade associations, individuals, academics and multi-stakeholder bodies – have sought to address different issues surrounding armed contractors. Most of them, however, have been developed in response to incidents that already occurred. This reactive approach to accountability, while useful for addressing past problems, may leave the industry exposed to future problems. In other words, a code, standard or mechanism set up to prevent another Nisur Square incident may be very effective in doing so, but may fail to prevent a different and even more worrying incident in the future.



(Chuck Horton/Flickr)

This article begins with a brief overview of the most credible accountability initiatives, suggesting that the resulting collection forms a patchwork, rather than a framework for governing the conduct of armed contractors. The analysis then focuses on the process of selecting contractors, with a particular emphasis on the US Government. While cost has been a key factor in determining selection, the various initiatives discussed have made it possible for accountability and quality to be added as essential metrics. Ultimately, however, the failure of the accountability initiatives to remain current, much less forward-looking, means that the objective determinants of ‘accountability and quality’ may not be fit for purpose as the US and other Western powers begin to engage the services of armed contractors for assistance in new conflicts.

Accountability Initiatives: The Montreux Doctrine

On 31 March 2004, the global public had never heard of Blackwater Worldwide and was largely unaware that private armed contractors were operating across Iraq and Afghanistan. That day, however, four ex-US servicemen working for Blackwater on a State Department contract were ambushed in Fallujah. They were killed, their bodies were dragged through the streets and burned, and their corpses were hanged from a bridge. The next day, the gruesome images of the ill-fated contractors shocked the world. There was a huge amount of sympathy for these Americans who met such a horrific demise, but many began questioning what they were doing there in the first place and whether their presence was legal. Eventually, the international community began to try to answer those questions.

By the time Blackwater’s Nisour Square incident occurred in September 2007, the “Swiss Initiative,” led by the International Committee for the Red Cross (ICRC) and the International Law Division of the Swiss Foreign Ministry, was already working to develop international guidance for private armed contracting. The first output of that initiative was the Montreux Document on Pertinent International Legal Obligations and Good Practices for States related to Operations of Private Military and Security Companies during Armed Conflict. Following a series of intergovernmental and expert meetings, seventeen initial states established the Document on 17 September 2008. It sets forth 27 paragraphs restating international legal obligations relevant to private security contracting and an additional 73 paragraphs detailing “good practices” for states (and potentially other entities) as they interact with the industry.⁴

Currently, fifty-one countries, the European Union (EU), the North Atlantic Treaty Organization (NATO), and the Office for Security and Cooperation in Europe (OSCE) have endorsed the Montreux Document, making it the most widely supported international instrument specifically concerning private security companies.⁵ While the Document neither creates nor alters international legal obligations, its “good practices” section, if implemented, could aid in the development of a new body of

customary international law. This means that, if states conform to the principles expressed in the Document, those principles will, over time, become obligatory rather than voluntary.

The ICoC and the ICoCA

The Montreux Document is focused on states, but in instances such as the Nisour Square shootings, it is the actions of the contractors at issue. Consequently, some of the experts and government officials involved in the Montreux drafting process recognized that it was also necessary to develop guidance that would raise the standard of the industry itself. Without the participation of the ICRC, the Human Rights Division (rather than the International Law Division) of the Swiss Foreign Ministry led a multi-stakeholder process from 2009 to 2010 to develop a code of conduct for private security providers. Three states – Switzerland, the US and the UK – an unspecified number of civil society organizations, and most of the major private security companies from Western states, as well as a few from the developing world, worked together with a number of experts, academics and clients of the armed contractors, to develop a code that would raise the bar for the industry. The resulting International Code of Conduct for Private Security Service Providers (ICoC) was signed into existence on 9 November 2010 by an initial fifty-eight companies.⁶ That number ultimately swelled to 708 signatories before signature was replaced by membership in the Association discussed below. While many signed in order to commit to the Code’s principles, signature also became a prerequisite for procurement and for membership in trade associations, thereby driving up the numbers.

“The Montreux Document is focused on states, but in instances such as the Nisour Square shootings, it is the actions of the contractors at issue.”

Understanding the Code’s significance requires a basic understanding of human rights law. International human rights laws apply to states, not directly to individuals. States are required to implement, through domestic legislation, the human rights principles contained in those laws. By signing the Code, private security companies voluntarily agree to abide by the principles of international human rights law, regardless of whether the relevant jurisdiction has incorporated them domestically. In addition to these human rights elements, the ICoC mandated two follow-on processes: the development of formal standards and the establishment of oversight mechanisms.

The Swiss continued to serve as the convener and facilitator for the development of what became a unitary oversight mechanism. Following several years of work by a Temporary Steer-

ing Committee comprised of three governments – the US, UK, and Australia – three civil society groups – Human Rights First, Human Rights Watch and the Geneva Centre for Security Policy – and four private security companies – Triple Canopy, Drum Cussac, Garda World and Aegis – the International Code of Conduct Association (ICoCA), launched on 19 September 2013. It is responsible for certifying companies under the ICoC, monitoring compliance with the ICoC, and hearing grievances concerning violations of the Code.⁷ The ICoCA is overseen by the Montreux Document Forum, a collection of interested states already participating in the Montreux Document. The Association, however, has yet to become fully operational. Signature of the ICoC alone has ceased, as the emphasis is now on companies participating in the Association. So far, 140 companies have become members.

The Standards

The multi-stakeholder initiatives that created the ICoC and ICoC Association were essentially self-governing ad hoc processes. Standards, on the other hand, are developed and implemented through formal procedures situated within an extensive set of national and international institutions. Following completion of the ICoC in 2010, the United States Department of Defense contracted ASIS International, the premier security-related standards drafting organization, to develop formal standards for private security companies in line with the ICoC. ASIS determined that the standards would be best developed under the rules of the American National Standards Institute (ANSI) and then converted into international standards under the International Organization for Standardization (ISO) – a process that essentially involves different national bodies working together to make sure the standard is as good as possible and not slanted toward any one state. Four standards were developed in the series, but only two are relevant to the present analysis.

ANSI PSC.1

The ANSI/ASIS PSC.1 Standard, developed by a Technical Committee of over two hundred people from twenty-six different countries, is by far the most detailed instrument relevant to the regulation, governance and oversight of the private security industry. It is the flagship Standard of the ANSI/ASIS PSC Standards Series which seek to operationalize the ICoC within a formal structure familiar to businesses. That structure, with both national and international supervision, provides auditable procedures for the development, certification, and monitoring of ongoing compliance. PSC.1 pushes the envelope with regard to business standards as the first to incorporate human rights requirements. The ICoC's purpose was primarily to commit signatories to human rights principles regardless of whether they were so obligated by law. The PSC Standard Series takes that voluntary commitment a step further and requires companies, in order to be certified, to have adequately incorporated compliance with international human rights principles into their operating policies and procedures. The PSC.1 Standard is cur-

rently in the process of being converted into a full international Standard, ISO 18788.

ANSI PSC.2

Given the unusual nature of the PSC.1 Standard, it was understood from the outset that a second Standard would be needed to set forth the requirements for auditing PSCs. A conformity assessment standard, PSC.2 is based on ISO 17021 – the general standard for auditors – but tailored specifically to the unique needs of the PSC industry and the PSC.1 Standard. This Standard focuses on the expertise required to assess companies operating in the most challenging environments on Earth. Traditional auditors, accustomed to examining more conventional businesses, typically lack the discernment and expertise necessary to understand the legal, human rights, and operational requirements of the PSC Standards. PSC.2 therefore provides an extensive list of competencies such as familiarity with the “Terminology, practice, and understanding of the rule of law and use of force ... human rights impact assessment ... methods for personal security and protection of persons ... [and] methods and practices for continuity, emergency and recovery management.”⁸ Given the breadth of skills needed, it suggests the use of audit teams, as few individuals would be able to address all the issues competently. So PSC.1 sets out what companies need to do and PSC.2 sets out how to audit those companies and their activities.

“The multi-stakeholder initiatives that created the ICoC and ICoCA were essentially self-governing ad hoc processes.”

UN Guiding Principles on Business and Human Rights

In addition to the industry-specific elements of the Montreux Document, the ICoC, the ICoC Association, and the PSC Standards Series, a number of general business and human rights initiatives are relevant to the operation of private security companies. The most significant is the UN Guiding Principles on Business and Human Rights, a set of thirty-one principles that stipulate how businesses incorporate human rights considerations into their operations – regardless of whether applicable law actually imposes human rights obligations (much like the ICoC). Conceptually, the Guiding Principles espouse a tripartite framework of “Respect, Protect, Remedy.” The elements are: “the State duty to protect against human rights abuses by third parties, including business; the corporate responsibility to respect human rights; and the need for more effective access to remedies.” While non-binding, the Guiding Principles are increasingly informing the dialogue surrounding businesses, including private security companies, that operate transnationally. Some governments, including the UK, are beginning to incor-

porate them into national policy.

The Patchwork Problem

This rather brief overview of the most credible accountability initiatives paints a rather disjointed picture. While there are certainly connections between the Montreux Document, the ICoC, the ICoC Association, PSC.1, PSC.2 and the UN Guiding Principles, those connections are not always clear or explicit. Furthermore, the various initiatives do not seamlessly fit together. For example, what relationship is there between the independent certification of companies under PSC.1 and the certification of member companies of the ICoC Association? Do auditors of private security companies need to ensure compliance with the UN Guiding Principles? These unanswered questions hinder the potential effectiveness of the patchwork of initiatives. While efforts are ongoing to make the various elements of accountability work together, there may be a growing urgency to that need.

The US and its allies are increasingly engaged in military activities to combat ISIS, and several other conflicts seem to be bubbling in different parts of the world. On 22 September 2014, popular American commentator Bill O'Reilly proposed the creation of a private army of 25,000 specially trained contractors to address the situation in the Middle East.⁹ While the proposal has not gained serious traction, it is an indication that private armed contractors are seen as a means of avoiding a serious military engagement. Consequently, contractors may be asked to take on new responsibilities and become involved in new ways.

While legal concerns certainly restrict how contractors can be used, private security companies are already encountering issues that are not addressed in the accountability patchwork. For example, contractors are increasingly being hired to direct and oversee the activities of foreign military or police personnel. What responsibility do such contractors have if the foreign personnel violate international law or commit human rights violation under their watch? Many new issues also arise with regard to the use of remotely operated technology. Does a contractor, employed by a state, operating a drone or weapons system, for example, have responsibility for killing civilians? These are just some of many complex and unanswered questions not addressed by regulatory initiatives to date.

Selecting Private Security Today

Despite the volume of accountability initiatives and the involvement of various governmental bodies in them, it is still unclear what will guide the selection of armed contractors for future conflicts. In May 2012, for example, the then US Deputy Assistant Secretary of State for Democracy, Human Rights, and Labor, Daniel Baer, gave a speech at a conference in London hosted by the UK Foreign and Commonwealth Office and the Security in Complex Environments Group (SCEG). In the

question and answer period, he was asked directly whether the United States Department of State, on whose contracts most of the major scandals of the Iraq and Afghanistan wars had occurred, had any intention of using the various regulatory initiatives in which it was participating as a prerequisite for its own procurement. He could not respond in the affirmative and was unable to shed light on how the State Department would proceed to incorporate accountability measures. Two years later, following extensive internal and external discussions, the State Department has said it will incorporate PSC.1 compliance and ICoCA membership into its next major contract, but it has not yet done so.

In contrast, the 2011 US National Defense Authorization Act (NDAA) mandated that the Department of Defense develop and implement business and operational standards for private security contractors.¹⁰ Given that the Department funded the ANSI PSC Standards Series, it is not surprising that conformance to the Standards is now a prerequisite for procurement.

“While legal concerns certainly restrict how contractors can be used, private security companies are already encountering issues that are not addressed in the accountability patchwork.”

This is a significant change from the approach of the last decade. Lowest Price Technically Acceptable (LPTA) is the regulatory requirement often invoked for selecting contractors on government contracts.¹¹ In many ways, LPTA contracting is the bureaucratic response to concerns about waste in government expenditure. Ironically, it restricts the focus to cost, rather than quality or accountability, under the guise of “value.” The great advantage of the NDAA 2011 requirement that private security companies be certified to a standard in order to be eligible for procurement is that it mitigates the LPTA requirements. Prior to that requirement, if fifty companies bid on a contract, under the LPTA metric the government might have been forced to choose the contractor technically able to perform most cheaply, but likely to perform badly on other important but harder-to-measure dimensions, such as incorporation of international law and human rights norms into operating procedures. Today, on an identical contract, there may only be three or five companies that have managed to go through the certification process to even be able to bid. The legal requirement of NDAA 2011 has infused quality and accountability into the procurement process while still emphasizing “value.”

This schism between US State Department and Defense Department contracting brings up the first issue that the next wave of wartime contracting will face. Governments are not homo-

geneous entities. So while a country may be participating in the Montreux Document, may hold a spot on the Montreux Document Forum, may hold a seat on the ICoCA and may publicly advocate the UN Guiding Principles, differences of process and priority among different government departments may lead to a cluttered battlefield with higher price, higher quality, more accountable contractors alongside low cost, low quality, unaccountable contractors working for the same government.

The second issue, as has been noted, is that these initiatives do not comprehensively address all the issues that have arisen to date. The various initiatives have been and will continue to be extremely helpful in raising the professionalism, quality, accountability and reliability of the industry, but they will not resolve murky areas of legal twilight. Even under the accountability initiatives, there is still a chance that issues will arise that are simply not covered. There is the potential, therefore, that incidents involving “certified” contractors will carry substantial backlash against all the accountability initiatives. Legal issues not addressed by the regulatory initiatives could lead to some or all of the initiatives being tarnished or even abandoned for ineffectiveness, reverting the process of selection back to a simple determinant of lowest cost.

Finally, many of these regulatory initiatives were designed to address what happened in Iraq and Afghanistan between 2001 when the Coalition entered Afghanistan and 2010 when the ICoC was completed. They do not address future issues that may arise. As noted, the current initiatives form a disconnected patchwork plagued by gaps and uncertainties. As new operations unfold, the initiatives will need to be revisited to make sure that the standards being set match the operation of the industry. Otherwise, a government may be selecting based on quality, but quality for the wrong job.

Conclusion

The proliferation of private armed contractors in zones of armed conflict was followed by a proliferation of initiatives aimed at establishing accountability for the industry. Some of those initiatives, paired with new procurement rules for government departments in several countries, have shifted the focus from cost to accountability in selecting companies to provide armed security. As the world faces a likely upsurge in this sort of contracting, it remains to be seen whether the extensive regulatory, governance, and oversight efforts of the last decade will prove effective in ensuring higher quality, more responsible armed contractors, or whether gaps in the system will lead to the rejection or circumvention of those accountability measures in favor of the lowest priced contractors. Failing to address these foreseeable complications may prove detrimental to the private security industry, to the credibility of governments employing armed contractors, and to the overarching aims of international security.

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North Korea: The Myth of Maxed-Out Sanctions

BY **Joshua Stanton**

On December 19, 2014, President Obama publicly blamed North Korea for the cyberattack against Sony Pictures and for the subsequent cyberterrorism against the American people, and promised to “respond proportionally.”¹ Almost immediately thereafter, one could hear a familiar narrative repeated, typified by New York Times correspondent David Sanger, who wrote that “North Korea is under so many sanctions already that adding more seems futile.”² One could have heard similar arguments in 2006,³ after North Korea’s first nuclear test, and in 2013, after its third nuclear test.^{4,5} A variation of this argument is that “Washington ... can do little ... without the cooperation of China.”⁶

For years, journalists have quoted “experts” who insisted that U.S. sanctions options against North Korea were exhausted and had failed as an instrument of policy. As a matter of both fact and law, however, that is false; it even suggests that these experts have not read and understood the sanctions authorities. Why does this view persist, then? Some scholars may accept and propagate it because they oppose sanctions as a matter of policy. Others have simply ceased to question a myth that has entered the received wisdom.

A true understanding of the potential effectiveness of sanctions first requires an understanding of what these sanctions are, what they are not, and how they work. This article will first summarize the sanctions authorities – U.N. Security Council resolutions, and the U.S. sanctions that should be an important part of the effective enforcement of the measures that the U.N. Security Council has adopted. It will also explain the role of the Treasury Department in regulating the international financial system, and the power this gives the United States to isolate the North Korean government from that system. It will explain which U.S. and U.N. sanctions against North Korea have succeeded and failed, and why. Finally, it will explain what current U.S. national sanctions do, and what they do not do. Only after one understands how little the current sanctions do – and how much they could do – can one begin to understand how to strengthen them into an effective part of a coherent foreign policy.

As the Congressional Research Service stated in a 2011 report, “Contrary to commonly expressed views, the United States does not maintain a comprehensive embargo against North Korea.”⁷ Until President Obama signed Executive Order 13,687 on Jan-



The Juche Tower (officially the Tower of the Juche Idea) is a monument in Pyongyang, North Korea. The tower is named after the principle of Juche, developed by Kim Il Sung as a blend of autarky, self-reliance, nationalism, Korean traditionalism, and Marxism-Leninism (Wiki, 2013)(Matt Paish).

uary 2, 2015,⁸ U.S. sanctions against North Korea were a mere shadow of their counterparts applicable to Iran, Syria, or Burma, and were also much narrower than those applicable to Belarus and Zimbabwe.^{9,10}

Recently, some scholars and reporters have begun to question the strength and potential of current North Korea sanctions.¹¹ Even before the Sony story broke, Bruce Klingner of the Heritage Foundation wrote of the “misperception” that North Korea is “the most heavily sanctioned country in the world” and that “nothing more can be imposed.”¹² After the attack, The Wall Street Journal’s Jonathan Cheng interviewed the author of this article to question the strength of current North Korea sanc-

tions and explain some of the options that remain.¹³ Indeed, Jon Stewart described the actual state of North Korea sanctions more accurately on “The Daily Show” than The New York Times did in its reporting, when Stewart expressed amazement that the North Korean regime is “still allowed to use our banking system,” and suggested that stronger sanctions were needed.¹⁴

Kurt Campbell, Chairman and CEO of The Asia Group and President Obama’s former Assistant Secretary of State for East Asian Affairs, has become one of this myth’s most strident critics. In a September 5th speech at the Center for Strategic and International Studies, Campbell said:

“We often think of North Korea — I certainly did — as one of the most sanctioned countries in the world, with almost impossible objective ... obstacles for people wanting to travel, invest, or the like. It turns out, when I was at the State Department, working on Myanmar, or Burma, comparing Burma to North Korea is night and day. Burma has much more in the way of sanctions and challenges associated with interactions. And I do think if we faced a set of further challenges with respect to North Korea, it would be possible for us to put more financial pressure on North Korea. And I think we need to let our Chinese friends know and understand that some of the things that have been contemplated by the new regime, if followed through on, would entail and involve a reaction that is much more strenuous than [what] we’ve seen in the past. And I think that element of our diplomacy is likely to be necessary as we go forward.”¹⁵

As Campbell stated, the United States requires the cooperation of other states and financial institutions to make sanctions work effectively. Although voluntary cooperation is always the most effective and preferable means to enforce sanctions, the

dominant position of the United States within the international financial system allows it to secure a degree of cooperation from banks, including Chinese banks, even without the active cooperation of all governments. To another extent, the United States already has enforceable commitments by member states to cooperate with the enforcement of sanctions against North Korea, in the form of a series of U.N. Security Council sanctions resolutions.

U.N. Security Council Sanctions

Since 2006, the United Nations has passed five sanctions resolutions against North Korea (1695, 1718, 1874, 2087, and 2094). These resolutions prohibit North Korea from possessing and trafficking in WMD technology, from importing luxury goods, and from importing or exporting most weapons, along with related materiel or services. The resolutions also require member states to apply financial safeguards against facilitating these prohibited activities through wire transfers, credit, and bulk cash smuggling. Appropriately, U.N. sanctions direct member states to avoid sanctioning humanitarian and diplomatic activities, and “developmental purposes directly addressing the needs of the civilian population.” They still include no sanctions directed at North Korean officials responsible for crimes against humanity, as recommended by a U.N. Commission of Inquiry in February of this year.¹⁶

Whatever the strength of these measures in theory, their enforcement still depends on the consensus of Security Council members to interpret them, and on member state governments to enforce them. Due to a combination of U.N. bureaucracy and

The U.N. Security Council unanimously votes to adopt a resolution expanding financial sanctions on North Korea in 2009 (Eskinder Debebe, UN Photo).





Ambassador Stephen Bosworth, then-U.S. Special Representative for North Korea Policy, speaks with the press outside the United States Mission October 25, 2011 following talks between the United States and North Korea. Standing to the Ambassador Bosworth's right is Ambassador Glyn Davies, who succeeded Ambassador Bosworth as U.S. Special Representative for North Korea Policy (Eric Bridiers, U.S. Mission Geneva).

poor enforcement by some member states, U.N. sanctions have slowed, but not stopped, North Korea's WMD programs.¹⁷ China, which voted for all five resolutions, has never enforced them in good faith. Europe enforces them unevenly, and the U.S. has often overlooked its responsibility to enforce them through its stewardship of the dollar-based financial system.

China's failures to enforce U.N. sanctions are too extensive to describe here fully, but a series of examples illustrates China's pattern and practice of non-enforcement.¹⁸ In 2007, Secretary of State Condoleezza Rice complained to the Chinese government about its failure to inspect and intercept a shipment of missile parts aboard a North Korean flight to Tehran as it refueled in Beijing.¹⁹ In 2008, China failed to inspect two containers of rocket fuses that were shipped from North Korea to Iran, via the Chinese port of Dalian.²⁰ In 2009, at least two North Korean arms shipments to Iran, believed to be for the eventual use of Hamas or Hezbollah, passed through Chinese ports²¹ or airspace.²² A North Korean shipment of chemical reagents and

protective suits bound for Syria may have passed through China in 2009.²³ In 2010, France seized a shipment of arms-related materiel en route from North Korea to Syria via Dandong, China.²⁴ In 2011, China blocked²⁵ a report by a U.N. panel of experts that implicated it in North Korean arms transfers to Iran.²⁶ In 2012, a Chinese state-owned firm, Hubei Sanjiang Space Wanshan Special Vehicle Co., sold North Korea chassis for missile transporter-erector-launchers.²⁷ In 2014, the U.N. Panel of Experts reported that a U.N.-sanctioned firm linked to North Korea's WMD programs was operating openly at a Chinese trade show.²⁸ As recently as November 2014, the same company still operated in China and Russia.²⁹ The U.N. Panel of Experts has named multiple Chinese firms that have facilitated shipments of luxury goods to North Korea.³⁰

According to statistics collected from Chinese customs data by South Korea's intelligence services, Pyongyang's luxury goods expenditures have tripled since Kim Jong Un's succession in 2011, to \$644 million, an amount six times greater than what the

regime spent on importing food for its hungry.³¹ North Korea still obtains luxury items from Europe, goods it uses to buy the loyalty of a small elite that lives opulently while 84% of North Korean households have “poor” or “borderline” food consumption during the lean season.³² In 2013, a reporter analyzed photographs of Kim Jong Un’s new ski report at Masikryeong Pass, and identified “Canadian snowmobiles, Swedish snow-blowers and Italian and German snow ploughs.”³³ Although North Korea probably obtains some of these luxury goods through China, North Korea also obtains luxury goods directly from European suppliers.³⁴

South Korea’s continued bulk cash payments to North Korea through the Kaesong Industrial Complex, without meaningful financial controls on North Korea’s use of those funds, arguably violate U.N. Security Council Resolution 2094’s requirement that member states must “prevent the provision of ... any financial or other assets or resources, including bulk cash, that could contribute” to North Korea’s WMD programs.³⁵ Kaesong, a joint venture in which South Korean factories use North Korean laborers selected by the North Korean government, pays the “wages” of the workers directly to Pyongyang. This arrangement has long raised questions about the ethics of Kaesong’s labor standards, and how much the workers themselves are actually paid.³⁶ As Treasury Undersecretary David Cohen recently said, “Precisely what North Koreans do with earnings from Kaesong, I think, is something that we are concerned about.”³⁷

The enforcement of U.N. sanctions is also hobbled by a cumbersome process that requires “a consensus of [the] members” of the Security Council, which in turn acts on recommendations by a panel of eight experts.³⁸ Although the quality of the Panel of

Expert’s recent reports has been excellent, the designation process requires the unanimous approval of the representatives of 15 governments to designate an offending party, name an alias, or add an item to a list of materials North Korea is prohibited from importing or exporting. Consequently, a full year after the M/V Chong Chon Gang was seized in Panama, loaded with MiG-21 fighters and anti-aircraft missiles in transit from Cuba to North Korea, the U.N. Committee responsible for designating violators had failed to designate any of the entities involved in the arms shipment. The former head of the U.N. Panel of Experts responsible for investigating the shipment called the U.N.’s slow response “regrettable.”³⁹ By the time the U.N. designated the North Korean shipping companies involved in the violation, those companies had an ample opportunity to shift their funds to other front companies and resume operations under new aliases.⁴⁰

Because of the impracticality of waiting for this consensus, some member states publish their own lists of sanctioned North Korean entities and prohibited luxury goods. Those lists are often inconsistent (for example, the U.S.⁴¹ and EU⁴² lists of luxury goods, or the U.S.⁴³ and EU⁴⁴ lists of designated North Korean persons and banks). This is still better than what many states do – which is to publish no lists at all.

The Treasury Department’s Global Reach

The United States, as the single most important steward of the international financial system, has a special role in facilitating the enforcement of U.N. sanctions. Understanding the respon-

The United States Department of the Treasury Building, at 1500 Pennsylvania Avenue, is the third oldest building in Washington, dating from 1836. It now serves as the hub of U.S. economic power in the fight against cash flows to terrorists and insurgencies (Wally Gobetz).



sibility and power that come with that stewardship requires a brief discussion of the financial system, banking law, and how it has adapted to combat terrorism, proliferation, and the money that fuels both.

Before 9/11, when policymakers referred to “sanctions,” they usually meant broad trade sanctions, which, by themselves, have a mixed record of forcing determined targets to change their policies. At best, trade sanctions can induce a slow economic atrophy and retard a target’s development as a military threat.⁴⁵ Narrow and poorly enforced trade sanctions against South Africa took ten years to catalyze political change. Sanctions against Iraq were frustrated by corruption, poor enforcement, and cumbersome targeting, which allowed Saddam Hussein to transfer their effects to the Iraqi people.

After 9/11, the U.S. sought more focused ways to halt the funding of terrorists and their sponsors. The Treasury Department seized on America’s position as the hub of the global financial system. This hub consists of U.S.-based financial institutions that process dollar-denominated transactions, which account for the majority of international transactions. Even dollar transactions among non-U.S. parties flow through this system, utilizing correspondent accounts that foreign banks maintain in U.S. financial institutions. Thus, a hypothetical dollar payment from a buyer in China to a seller in Switzerland will flow from the seller’s Chinese bank’s correspondent account in a U.S. financial institution, to the buyer’s Swiss bank’s correspondent account in another U.S. financial institution. This system gives the Treasury Department the power to regulate many international transactions, and also gives foreign banks and companies a strong incentive to protect their access to the financial system, by complying with Treasury’s regulations.⁴⁶

Since 9/11, Treasury has harnessed its regulatory power over the dollar system to ferret out money laundering and terrorist financing within the millions of transactions flowing through the system. By availing themselves of the dollar system, banks subject themselves to Treasury’s regulatory authorities, and undertake obligations to know their customers, report large cash transactions, and report suspicious activity.⁴⁷ Treasury’s authorities allow it to gather financial intelligence, to block assets involved in illicit activity, and even to restrict or even block a foreign bank’s access to the dollar system.

Even non-dollar transactions are subject to indirect U.S. influence. The preferred course for using that influence is to gain the voluntary cooperation of entities, such as the European Central Bank, with the direct power to enforce sanctions against non-dollar transactions.⁴⁸ Other options are less voluntary; for example, a 2012 Iran sanctions law authorized sanctions against the financial messaging services that form the communications link between sanctioned Iranian banks and the financial system.⁴⁹ The largest of these services is SWIFT, a consortium based in Belgium. Shortly after this legislation passed, SWIFT reluctantly agreed to stop servicing 30 U.S.-sanctioned Iranian banks.⁵⁰ Treasury can also exert strong influence over third-

country banks that handle non-dollar transactions. For example, Treasury stopped Ankara-based *Türkiye Halk Bankası* from servicing Iranian oil sales in gold and euros,⁵¹ but later allowed payments to resume under an agreement to ease sanctions as nuclear negotiations continue.⁵² Last year, Treasury blocked the dollar-denominated assets of an Egyptian shipping company for helping Iran evade shipping sanctions through transactions denominated in dollars, euros, and UAE dirhams.⁵³ Transactions in gold may also be subject to direct U.S. sanctions.^{54,55}

Critics of the dollar system are quick to enumerate its shortcomings, but it is still the world’s most efficient and stable monetary system. Documents released by the U.N. Panel of Experts show that North Korea continues to use it for transactions, such as its 2013 arms deal with Cuba (see Annex XIII, Annex XX).⁵⁶ Despite concerns about U.S. debt and congressional paralysis, more than 60% of the world’s foreign exchange reserves are denominated in dollars,⁵⁷ and no currency is likely to compete with the dollar for supremacy as the world’s reserve currency in the near future.⁵⁸

Because the Treasury Department’s powers are not subject to vetoes or non-enforcement by China and Russia, they are more powerful enforcement tools than U.N. sanctions alone. In fact, the Treasury Department has demonstrated significant coercive power over Chinese banks. In 2005, not long before the Treasury Department sanctioned Banco Delta Asia, *The Wall Street Journal* reported that the Bank of China was under investigation for laundering North Korean funds.⁵⁹ The report concerned the reputation-conscious bank enough that after the Bush Administration’s 2007 disarmament deal with North Korea, and despite the express requests of the U.S. and Chinese governments, China’s chief negotiator at the six-party talks said that “the Bank of China had concerns about accepting” any of the illegally derived North Korean funds from Banco Delta Asia, and had refused to transfer the funds.⁶⁰

That influence still exists today. In May of 2013, two months after Treasury sanctioned the Foreign Trade bank, and a little more than a week after the introduction of a North Korea sanctions bill in Congress, China’s four largest banks — the Bank of China, the Industrial and Commercial Bank of China, the China Construction Bank, and the Agricultural Bank of China — all halted money transfers to North Korea.⁶¹ Other, smaller Chinese banks, like the Bank of Dandong, continued to move money for Pyongyang.⁶² At the lowest reaches of the financial ecosystem, North Korean money launderers still operate in Guangdong,⁶³ and more discreetly, in places like the British Virgin Islands.⁶⁴ Enforcing sanctions requires persistent attention to all levels of the financial ecosystem. As Daniel Glaser, the Assistant Secretary for Terrorist Financing, stated in a January 13, 2015 briefing to the House Foreign Affairs Committee, “China’s not going to do us any favors. China is going to work with us because it’s in their interests. We’ve seen that with China’s commercial banks time and time again.”⁶⁵

U.S. Banking Law

Most of the authorities for the Treasury's powers to regulate financial institutions are found in Chapter 53 of Title 31, U.S. Code, and in the regulations promulgated under those laws. The purpose of these laws is to protect the integrity of the financial system from financial crimes, such as money laundering. Traditionalists bristle when observers describe these authorities as "sanctions," but after 9/11 international financial regulators adopted standards for combating terrorism and proliferation, and banking laws increasingly share common purposes with sanctions authorities.⁶⁶

After 9/11, Congress added a powerful new tool to Title 31 – Section 311 of the USA PATRIOT Act. Section 311 authorizes the Treasury Department to impose additional monitoring and reporting requirements on any person, bank, or jurisdiction that the Treasury Department deems to be a "primary money laundering concern." In extreme cases, it allows Treasury to bar a bank or jurisdiction from the U.S. financial system entirely. Since section 311 was enacted, the Treasury Department has designated 18 financial institutions and four countries as primary money laundering concerns.⁶⁷ The countries included Nauru (from 2003 to 2008), the Ukraine (for three months in 2003), Burma (since 2004), and Iran (since 2011), but did not include North Korea, the world's only state counterfeiter of the U.S. dollar,⁶⁸ whose high-quality "supernotes" have necessitated multiple redesigns of the hundred-dollar note.⁶⁹ In practice, a primary money laundering concern designation can destroy a bank overnight, and can throw a targeted jurisdiction into an economic death-spiral.⁷⁰ Such a designation helped bring Iran's economy to the brink of collapse within three years after the passage of the Comprehensive Iran Sanctions, Accountability, and Divestment Act (or CISADA) of 2010.⁷¹ Section 311 designations forced Nauru and the Ukraine to stop turning a blind eye toward money laundering, and arguably helped to force reforms in Burma.⁷²

The Treasury Department has never designated North Korea under Section 311, but in September 2005, it designated Macau-based Banco Delta Asia for acting as "a willing pawn" for North Korea's laundering of counterfeit dollars.⁷³ The action caused a run on Banco Delta Asia, and would likely have caused its collapse had the government of Macau not taken control of the bank and blocked \$25 million in North Korean deposits.⁷⁴ By most accounts, the action was devastating to Kim Jong Il's finances, blocking one of the key streams of hard currency sustaining his regime.^{75,76}

Some senior U.S. government officials believe that the designation of Banco Delta Asia forced North Korea to return to talks and agree to give up its nuclear weapons programs.⁷⁷ In his book, *Treasury's War*, former Treasury official and Deputy Assistant to the President Juan Zarate quotes a North Korean diplomat as telling his American counterpart, "You Americans have finally found a way to hurt us." Unfortunately, the Bush

Administration accepted Kim Jong Il's false promises, traded away its leverage, agreed to return North Korea's illegally derived funds, and abstained from aggressive enforcement of U.S. anti-money laundering laws – all without having verified North Korea's disarmament. North Korea adapted by decentralizing its money laundering networks, and found new banks that were willing to accept its business.⁷⁸ Two nuclear tests later, and despite the still-unrealized potential of Executive Order 13,687, U.S. sanctions against North Korea are not much stronger than they were when President Bush relaxed them in 2008.

IEEPA, Regulations, & Executive Orders

The statutory authority for most targeted financial sanctions is the International Emergency Economic Powers Act, or IEEPA. The IEEPA authorizes the President to declare a national emergency when facing an "unusual and extraordinary threat" from abroad to "the national security, foreign policy, or economy of the United States." The Act authorizes the President to "investigate, regulate, or prohibit" nearly any transaction,⁷⁹ or to block any property in which the targeted foreign country or person has an interest. In most cases, the President invokes the authority of the IEEPA through executive orders. The executive orders most applicable to North Korea include Executive Order 13382, which targets WMD proliferation; Executive Order 13551, which blocks the property of named entities involved in proliferation, weapons trafficking, and money laundering with North Korea; and Executive Order 13570, which imposed a licensing requirement for North Korean imports to the United States in 2011. The Treasury Department implements those authorities through regulations published at 31 C.F.R. Part. 510.

As stated previously, the Treasury Department's IEEPA sanctions regulations against North Korea are a pale shadow of those imposed against Iran, Syria, or Cuba, or those previously imposed against Burma, Sudan, or Libya.⁸⁰ For example, executive orders and implementing regulations prohibit investments, loans, credit, and the provision of banking services to Iran.⁸¹ The North Korea sanctions regulations contain no such prohibitions. There are no broad-based, third-party sanctions against North Korea's financial sector (as with Iran and Burma). North Korea is not designated as a Primary Money Laundering Concern (also unlike Iran and Burma). Treasury did not apply an import licensing requirement to North Korea until 2011. Except for luxury goods, weapons, and sensitive technology controlled by the Commerce Department, "there are no Treasury prohibitions on exporting goods to North Korea."⁸²

Nearly a year after a U.N. Commission of Inquiry described crimes against humanity in North Korea whose "gravity, scale, and nature" have no "parallel in the contemporary world," the Obama Administration has yet to follow the Commission's recommendation to apply targeted sanctions to North Korean human rights violators, including Kim Jong Un.⁸³ It has blocked the funds of human rights violators in Sudan and Iran, and of the leaders of Belarus and Zimbabwe for suppressing democrat-



The Macau branch of Banco Delta Asia - the bank served as a central hub of North Korean laundering operations until being targeted by the Treasury Department in September 2005 (Ricky Chan).

ic opposition, but it has not blocked the funds of Kim Jong Un and his top officials. The Treasury Department cites public corruption as a basis for sanctions against Zimbabwe, Syria, Burma, and Belarus,⁸⁴ but not North Korea, which is estimated to have between \$1 billion⁸⁵ and \$4 billion⁸⁶ in assets in banks in Europe and China,⁸⁷ even as the World Food Program struggles to collect just \$200 million for a two-year program to feed hungry North Korean women and children.⁸⁸

Treasury's enforcement of its North Korea sanctions also lags far behind that of other sanctions programs. In each month of 2014, the Treasury Department designated dozens of persons and entities in a multitude of countries, thus blocking any of their assets that enter the dollar-based financial system.⁸⁹ In all of 2014, Treasury designated just two North Korean shipping companies and 18 individual merchant ships linked to the shipper behind the Chong Chon Gang incident.⁹⁰ Before the designations of July 2014, only 43 North Korean entities were listed, most of them minor trading companies and mid-level officials designated during the Bush Administration.⁹¹ By comparison, Treasury's list of specially designated nationals designates hundreds of terrorists and drug kingpins, hundreds of Iranian entities, hundreds of Cuban entities, hundreds of Balkan war criminals, 164 Burmese entities (including the members of its ruling junta), 50 Belarusian entities (including its President and most of its top officials), and 161 Zimbabwean entities (including its President, his wife, and many of his top officials).⁹² In 2014, the Obama Administration even designated some of Russian Presi-

dent Vladimir Putin's top advisors and financiers.⁹³

The Obama Administration may yet close this gap. On January 2, 2015, the President signed Executive Order 13,687. On its face, the new executive order is sweeping and powerful. It authorizes sanctions against any entity or official of North Korea's government or ruling party, and any person who provides material support to them. The rub, however, is that no person or entity is considered to be an official, entity, or material supporter of North Korea's government or ruling party until the Secretary of State and the Secretary of the Treasury declare it to be so. As with previous executive orders, the Obama Administration did not designate Kim Jong Un, any of his top officials, or any of North Korea's main government ministries under Executive Order 13,687. Of the 13 entities the Treasury Department designated, three had been designated previously, and ten were individuals, mostly low-ranking arms dealers who will be easy for North Korea to replace. As former CIA Director Michael Hayden stated, the effect of those designations is "symbolic at best."⁹⁴ As of January 19, 2015, approximately 70 low-to-mid-level North Korean officials and entities were designated. Still, Executive Order 13,687 has a far greater potential than any of its predecessor authorities. Its very breadth may deter foreign investment in North Korea. It may yet herald a new aggressiveness in the Obama Administration's enforcement of sanctions against North Korea.

Country-specific Sanctions Laws

Finally, Congress can also enact country-specific sanctions legislation, which is published in the notes within the IEEPA. Iranian sanctions are a model for how powerful sanctions laws can be, and how precisely they can target industries and agencies that support a targeted regime's offending policies. The Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA) and The Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRSHRA) blocked certain regime-controlled banks from the dollar system, and used the threat of financial sanctions to deny Iran credit, foreign investment, shipping, or oil revenue.⁹⁵ The Burma Jade Act of 2008 blocked the assets of leaders of the ruling junta and imposed comprehensive sanctions on Burma's banks. A series of laws encourages divestment from Sudan's oil industry, and blocks the assets of leaders of the Sudanese government and Janjaweed militias.⁹⁶

By contrast, there is no North Korea-specific sanctions law today, merely a law prohibiting arms sales and the export of sensitive technology to Iran, Syria, and North Korea, and prohibiting entities that do from receiving government contracts.⁹⁷ That may also change soon. In July 2014, the U.S. House of Representatives passed the North Korea Sanctions Enforcement Act (NKSEA) on a voice vote. On December 12, 2014, in the final days of the 113th Congress and shortly before President Obama blamed North Korea for the Sony cyberattacks and cyberterrorism, the Chairman of the Senate Foreign Relations Committee, Senator Robert Menendez, introduced a milder Senate version of the NKSEA. The NKSEA did not become law before

the end of the 113th Congress; however, in light of the events involving Sony and The Interview, the new Congress is likely to enact strong North Korea sanctions legislation, equal to or stronger than the version the House of Representatives passed in July 2014.

The premise of the NKSEA is that only secondary sanctions have any likelihood of success at putting effective pressure against North Korea. Section 104(a) of the NKSEA requires the designation of entities that the President finds to have engaged in prohibited conduct involving North Korea, including proliferation, arms trafficking, human rights abuses, censorship, luxury goods sales, and money laundering. Entities designated for engaging in such conduct will face the blocking of their assets, criminal penalties, and the forfeiture of any property involved in the commission of the offense. A 2015 version of the bill will likely include cyberattacks as conduct triggering mandatory sanctions.

Section 104(b) of the NKSEA provides for discretionary sanctions for other conduct, including evasions of U.N. Security Council resolutions, knowingly facilitating sanctions violations by others, failure to exercise “enhanced monitoring” of transactions with North Korea (as required by U.N. Security Council Resolution 2014), and kleptocracy by North Korean officials. A designation under this provision may result in the blocking of property, enhanced financial regulatory requirements, loss of government contracts, and enhanced shipping inspections.

Section 104(c) of the NKSEA blocks all assets of the government of North Korea that enter the dollar-based financial system. Like all of the NKSEA’s sanctions provisions, however, it will exempt food and medicine imports. It will also allow the Treasury Department to grant general licenses to facilitate low-level, non-governmental remittances and trade that are driving the development of a parallel, gray-market economy on which most of North Korea’s people now rely for their survival. Conversely, the NKSEA will require Treasury to target the North Korean officials and agencies responsible for what a U.N. Commission of Inquiry recently called “crimes against humanity.” It will call on the President to designate North Korea as a jurisdiction of primary money laundering concern. It will also set strict conditions for the lifting of sanctions, to prevent future administrations from relaxing sanctions prematurely.

Conclusion

None of this should suggest that it will be a simple matter to recreate the pressure imposed on North Korea after the action against Banco Delta Asia in 2005. Defectors report that North Korea has diversified its finances since 2007, using the kinds of decentralized money laundering methods long used by terrorists, drug cartels, and rogue states.⁹⁸ As Assistant Secretary Glaser stated in the January 2015 briefing, it remains a challenge to identify North Korea’s dispersed financial nodes. Yet North Korea’s financial footprint could not be less than that of Al Qa-

eda, and its financial resiliency could not be greater than that of Iran or Russia.⁹⁹ Treasury has experienced success against those targets,¹⁰⁰ and at detecting and interrupting deceptive financial practices generally.¹⁰¹ Given sufficient time, resources, and political will, Treasury can also apply effective financial pressure against Kim Jong Un’s regime, and deny it the means to sustain its military and security forces. Sanctions can make the legal risk of doing business with North Korea prohibitive. This will require the political will to sanction third-country entities that facilitate North Korea’s illicit activities, proliferation, and human rights violations, including its culpable waste of resources on luxuries and weapons while the North Korean people go hungry.

There are, of course, legitimate policy arguments about whether, when, and how to use sanctions as a policy tool. Sanctions are just one element of a broader policy that must include information operations, deterrence, interdiction, and diplomacy with both allies and adversaries. Just as carelessly targeted sanctions could have adverse humanitarian consequences, carefully targeted sanctions could be a tool to force reforms and more humanitarian uses of North Korea’s wealth.¹⁰² Sanctions can also target the security agencies that have cracked down on smuggling, border-crossing, the flow of information, and the rise of North Korea’s underground economy, and pry open the state’s impediments to North Korea’s development of free markets and freedom of information.

North Korea will certainly argue that tightening sanctions would interfere with diplomacy, but relations between North Korea and its interlocutors may have to get worse before they can get better, and can only show lasting improvement when North Korea is forced to accept openness and transparency.¹⁰³ Indeed, since President Obama signed Executive Order 13,687, North Korea – in an apparent effort to protect its financial relationships and brace itself for financial warfare – has redoubled its diplomatic outreach to Russia,¹⁰⁴ Japan,¹⁰⁵ South Korea,¹⁰⁶ and even the United States.¹⁰⁷ Enforcing U.S. sanctions against Chinese entities that violate U.N. sanctions and sustain Kim Jong Un’s regime could strain U.S. relations with China, but similar considerations did not prevent the U.S. from sanctioning Vladimir Putin’s top advisors.

North Korea could respond violently to sanctions, and given North Korea’s 2010 attacks against South Korea and its 2014 attacks against the United States, it would be an error to dismiss this. A greater intensification of sanctions enforcement, information operations, and military force are all options to deter North Korean threats, and North Korea’s leaders understand that provoking a war would likely foreclose their personal survival. If Kim Jong Un will not negotiate in good faith, would the United States and South Korea be willing to risk destabilizing North Korea, and to accept the risks and costs attendant to regime collapse, to achieve finality and certainty that diplomacy with North Korea may never offer?

Balanced against these challenges is the situation that is deteriorating today. North Korea may soon be able to deliver a nuclear

warhead to the United States. It has longstanding WMD proliferation relationships with Syria, Pakistan, and Iran. It has been a major arms supplier to Hezbollah, Hamas, and other terrorist groups. Last month, it directly threatened freedom of expression in the United States.

A final difficult question is when it is appropriate to relax sanctions in response to a target's concessions. Relaxing them too soon risks repeating President Bush's mistake of 2008, when he relaxed North Korea sanctions prematurely. Without the inducement of some sanctions relief, however, the target has no incentive to make concessions. These are all important questions to discuss before choosing any policy option, but it does no good to state—incorrectly—that the options themselves do not exist. Putin's top advisors.

**The views expressed in this article are the author's alone.*

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Avatars of Checkbook Diplomacy

From the Afghan Jihad to the Arab Spring

BY Ibrahim Warde



Mujahideen with Enfield rifles and an RPG-7 on way up to Saohol Sar Pass, Kunar Province, Afghanistan in August 1985 (Erwin Franzen).

Introduction

In a talk given at Harvard University's Kennedy School of Government on October 2, 2014, Vice-President Joe Biden complained that "our allies in the region were our largest problem in Syria. The Turks were great friends – and I have the greatest relationship with Erdogan, which I just spent a lot of time with – the Saudis, the Emiratis, etc. What were they doing? They were so determined to take down Assad and essentially have a proxy Sunni-Shia war, what did they do? They poured hundreds of millions of dollars and tens, thousands of tons of weapons into anyone who would fight against Assad except that the people who were being supplied were Al Nusra and Al Qaeda and the extremist elements of jihadis coming from other parts of the world." During the same talk, he expressed his frustration with the absence of a "moderate middle in Syria (...) because the moderate middle are made up of shopkeepers, not soldiers." This came barely two weeks after Congress approved "\$500 million dollars to train and arm "moderate" Syrian rebels."¹

The Vice-President later apologized to Turkey, Saudi Arabia and the United Arab Emirates, but the "gaffe" drew attention to the brave new world of checkbook diplomacy, where aid seldom goes where it is intended, and unanticipated outcomes are the rule. During the anti-Soviet jihad of the 1980s, a secular Afghan warned American and Saudi officials against cozying up to extremists, telling them, "For God's sake, you're financing your own assassins."² The United States and Saudi Arabia were then lavishing money and weapons on unsavory characters, giving little thought to the possibility of a blowback or boomerang effect—that they would in effect be funding and arming their future enemies. It is indeed ironic that the principal bankrollers of the jihad later became the main targets of offshoots of that jihad. By the same token, a non-negligible part of the money and weapons sent by the United States to Iraq, in particular as part of the "Sunni awakening", is now in the hands of extremists.³ Yet with the near-exclusive focus on military developments, the financial front of the war on terror is all but ignored.⁴ This ar-

ticle traces the evolution of checkbook diplomacy in conflicts involving the Islamic world. Most of the cautionary tales involve the Afghan jihad against the Soviet Union. The article discusses three sets of dynamics which, combined, have produced an explosive mix: the “good Muslim, bad Muslim” perspective, the trend towards “privatization of foreign policy,” and the “hedging” approach.

Good Muslims, Bad Muslims

The year 1979 marked a turning point, as a series of landmark events transformed the Islamic world. On January 16, after months of turmoil, the Shah of Iran, America’s staunch ally and surrogate Persian Gulf policeman, left his country, signaling the victory of revolutionary forces, which would soon be dominated by Muslim clerics. In Pakistan, military dictator Zia-ul-Haq, beset by domestic and international difficulties, announced on October 21 the establishment of a “genuine Islamic order.” On November 20, a group of Sunni extremists seized the Grand Mosque of Mecca, the holiest place of Islam, and called for the overthrow of the House of Saud. It took the intervention of French Special Forces to put an end to the rebellion. On November 4, 1979, Iranian students stormed the U.S. embassy in Tehran, sacked it and took 49 U.S. diplomats hostage. The crisis, which lasted 444 days, further stirred up passions in both countries. On November 21, as (unsubstantiated) rumors that American and Israeli forces had entered Mecca, the American embassy in Islamabad was burned down by an angry mob. And most dramatically, on December 23, Soviet troops invaded Afghanistan. Each of these developments brought with it other crises. The Mecca events led to anti-American riots in Pakistan and elsewhere. In September 1980, Iraq’s army attacked Iran. The Iraq-Iran war, one of the deadliest of the twentieth-century, lasted eight years. During that war, Iraq received financial and military support from a vast and heterogeneous group of countries, ranging from conservative oil-producing neighbors such as Kuwait and Saudi Arabia, to Western powers such as the United States and the United Kingdom. The principal concern of these countries was to contain the expansion of the Iranian brand of Islamic fundamentalism. In the process, they armed and financed an ally who soon turned to implacable enemy.

The Soviet invasion triggered a jihad that would be nurtured by a coalition of the United States, Saudi Arabia and Pakistan, with China, Egypt and the United Kingdom playing lesser roles.⁵ Each of these countries was then responding in its own way to all those momentous events. In the United States, the Iranian revolution and the Soviet invasion resulted in significant policy changes. One was the rise of foreign policy hawks, partisans of a hard line against the Soviet Union. President Carter himself, previously quite accommodating toward the Soviet Union, increasingly aligned his positions with those of the hardliners. The Carter doctrine stated that the United States would use military force if necessary to defend its interests in the Persian Gulf. In the binary world of the cold war, a new distinction was born, separating “good” and “bad” Muslims, represented respectively

by Saudi Arabia (and other US allies) and Iran. The former were generously funded, whereas the latter were subjected to wide-ranging financial sanctions.⁶ Thus started (or restarted, if we take into account, the earlier and far more limited U.S. attempts to boost the Muslim Brothers in the 1950s and 1960s)⁷ the dangerous game of playing politics with religion. The sectarian divide separating Sunnis and Shia kept growing wider.

In a memoir covering that period, Robert Gates, who headed the Central Intelligence Agency between 1991 and 1993, revealed that the secret program to help the Afghan rebels was actually initiated on July 3, 1979, which is six months prior to the Soviet invasion.⁸ In a 1998 interview, Zbigniew Brzezinski, Jimmy Carter’s National Security Advisor, confirmed the chronology, boasting that playing the “Islamic card” was not simply an ad hoc response to the Soviet invasion. He asserted that he had conceived “the secret operation which had the effect of drawing the Russians into the Afghan trap” six months before the entry of Soviet troops.⁹ In Pakistan, a mix of motives explains the paradoxical turn of events. Since 1979, two seemingly contradictory trends fed off each other: a close alliance with the United States and the rise of state-sanctioned Islamic fundamentalism. The Islamicization policies of Pakistani leader Mohammed Zia-ul-Haq, a staunch ally of the United States, were accompanied by the strengthening of the Jamaat e-Islami group, whose student wing had a virulently anti-American outlook. It was in the name of those very policies that the group attacked the American embassy—for which the country’s ruler apologized profusely.¹⁰ It was also during Zia’s rule (1977-88) that a network of madrasas, was created. Those madrasas, now widely perceived as promoting hate, would only gain international prominence following the September 11 attacks. The Saudis, challenged on many fronts—both the Mecca uprising and the Iranian revolution challenged their religious legitimacy; the Soviet invasion of Afghanistan was perceived as a political and economic threat—became an important participant in the anti-Soviet offensive.

In this alliance of convenience that involved the United States, Saudi Arabia and Pakistan, there was at first a clearly defined division of roles. Pakistan micromanaged the anti-Soviet resistance through its own ISI (Inter-Services Intelligence),¹¹ while the Saudis handled financing and religious propaganda, and the United States provided strategic guidance, money, weapons and technical assistance.¹² The alliance seemed to work for everyone: Pakistan was achieving national and regional goals by controlling a neighboring country and was generously rewarded for it; the United States had found eager proxies to fight what turned out to be “the last battle of the cold war”; and Saudi Arabia had found a cause that would relieve political and religious pressure at home while enhancing the country’s stature throughout the Islamic world.¹³

The aid provided to the Mujahideen, as well the considerable financial, political and military efforts to foster a pan-Arab jihad, were undoubtedly major factors in the strengthening of Al Qaeda, and paved the way for Islamic terrorism in later years. In



The former front gates of the U.S. Embassy in Tehran, Iran. The embassy has been officially closed since November 4, 1979, when the compound was stormed by Iranian revolutionaries. The resulting hostage crisis lasted for 444 days. (David Holt).

that respect, the Frankenstein monster metaphor is particularly apt. Thousands of Afghan Arabs (a misnomer since the category included all non-Afghan mujahideen) graduated from Afghan training camps before leaving for unknown destinations. Following the victory of the Afghan resistance against the Soviet Union, the monster turned against its creators. Hardened, fanaticized warriors became rebels without a cause. To be sure, they latched on to the new battlefields of the 1990s, some of which (Bosnia and Kosovo) had battle lines that were not dissimilar to those of the Afghan jihad. Muslims were victims of ethnic cleansing, and the United States (now in a post-cold war world spearheading international coalitions under the auspices of NATO and the United Nations) was once again allied with other Sunni countries. There were also other “jihad” with their own political dynamics in places such as Chechnya and Kashmir. But simultaneously, new grievances turned those jihadi soldiers against the United States and Saudi Arabia. One was the abandonment of the Mujahideen following the Soviet withdrawal from Afghanistan. Another even more significant grievance was the stationing of American troops on Saudi soil following the first Gulf War.

Cultivating religious extremism seemed to make tactical sense,

based on the U.S. assumption- influenced by Pakistani intelligence- “that only the most radical Islamists could fight with determination.”¹⁴ Washington’s favored warlord was Gulbuddin Hekmatyar, probably the most fanatical, the most violent--and also the most anti-Western. The conscious decision to instill religious fanaticism among the young would have a long-term impact, and it would prove impossible to reverse. The US Agency for International Development (USAID) spent \$51 million on an educational grant between 1984 and 1994 to the University of Nebraska in Omaha and its Center for Afghanistan Studies. The goal was to produce books in the dominant languages of Dari and Pashtu, which would help stoke anti-Soviet hatred. Those books were filled with violent images and militant Islamic teachings, emphasizing jihad. According to agency officials, children were taught to count with illustrations showing tanks, missiles and land mines.¹⁵

As in most covert operations, support to the Afghan resistance started with money. The initial infusion of cash was modest (“somewhat more than half a million dollars,” according to Gates),¹⁶ though “key alliances were established with Saudi Arabia and Pakistan, and the first elements of an extraordinary logistics pipeline from suppliers around the world were assem-

bled.”¹⁷ Of special significance was the Saudi decision to match dollar for dollar U.S. spending in Afghanistan.¹⁸ Spreading money became a central part of the joint effort. Howard Hart, who as CIA representative in the Pakistani capital became the “quartermaster of the Mujahideen,” understood his orders as: “You’re a young man; here’s your bag of money, go raise hell. Don’t fuck it up, just go out there and kill Soviets.”¹⁹ By the same token, the Saudis’ “cash dollars” had been their “calling card.”²⁰

Between 1979 and 1984, the U.S. share of the funding for the Mujahideen was \$250 million—an amount matched by the Saudis.²¹ Since then, as many patrons of the Afghan jihad shifted objectives—from simply “bleeding the Soviets” to defeating them—the sums provided to the insurgents escalated accordingly. Or was it the other way around? Either way, political and budgetary constraints crumbled. With the funding surge of October 1984, the very nature of the support to the jihad changed. In the words of Robert Gates, Washington started “pouring it on.” “The United States and its friends—sensing both a Soviet challenge and a Soviet vulnerability—likewise expanded their covert assistance to anticommunist resistance forces all over the world; new money and new weapons cascaded in to them.”²² And all with Congressional support, and often in response to congressional pressure.²³ Indeed, a handful of members of Congress had taken up the cause of the Afghan jihad with a passion. One was Texas Congressman Charlie Wilson, who used his seat on the Defense Appropriations Subcommittee to steer considerable amounts of money to the Mujahideen. In one of his encounters with the director of the Central Intelligence Agency (CIA), the Congressman told an incredulous William Casey:

“Mr. Director, I’m going to drown you in money. You ask for it and I’ll pay for it.”²⁴ Charlie Wilson later colluded with the CIA and the Pentagon to “arrange an annual feat of budgeting gimmickry that siphoned Defense Department money to pump up the funds available for Afghan covert action.”²⁵

For fiscal year 1985, the amount appropriated for the Afghan jihad—\$250 million—was equal to that of the five previous years combined. It nearly doubled to \$470 in 1986, and increased again to \$630 million in fiscal 1987.²⁶ Much of the money came from the defense budget, though the covert operations were undertaken by the Central Intelligence Agency.²⁷ In the words of Steve Coll, “even by its own rich standards, the jihad was now swimming in money.”²⁸

Saudi Arabia & the Privatization of Foreign Policy

Prince Turki bin Faisal, the long-time head of Saudi intelligence (later the ambassador to the United Kingdom and the United States), once told an American intelligence official: “We don’t do operations. We don’t know how. All we know how to do is write checks.”²⁹ That was certainly true of an earlier period. The end of the Vietnam War, the Watergate scandal, and economic turmoil coincided with the unprecedented oil windfall in Saudi

Arabia. With Congress, especially following the Church Committee revelations,³⁰ trying to rein in foreign adventures, the Saudi government started financing, with no questions asked, covert operations in countries such as Angola and Nicaragua.³¹

Over time however, the Saudi role evolved well beyond that of a “bank teller.” According to Steve Coll’s account, the prince later became “an architect of Afghanistan’s destiny — and of American engagements with Islamic radicalize — in the two decades after 1979. He picked winners and losers among Afghan commanders, he funded Islamist revolutionaries across the Middle East, he created alliances among these movements, and he paid large subsidies to the Pakistan intelligence service, aiding in its rise as a kind of shadow government.”³² One problem encountered by the Saudis was that of matching American expenditures in a context of declining oil prices. Oil revenues had declined from a high of \$118 billion in 1981 to \$14.5 billion in 1986.³³ The Saudi Treasury was also depleted by the rapid growth of foreign policy-related expenditures, which included the funding of Saddam Hussein’s war against Iran. Given the general discontent of the population over declining economic standards, there were limits to the Saudi government’s checkbook diplomacy. This is where the private sector and Saudi society were called on to contribute further to the Afghan jihad. Wealthy merchants, some of whom had created their own foundations, responded generously, while people of more modest means took to making anonymous donations in ubiquitous collection boxes. This is how the Islamic charities came to play a central role in the Afghan jihad.³⁴ From foreign pilgrims in Saudi Arabia to worshippers in foreign mosques, everyone was expected to contribute. Comparable dynamics led other oil-rich states such as Kuwait, the United Arab Emirates, and Qatar (before it upgraded its role as discussed later) to do the same. Islamic NGOs and charities were the logical conduits for all those funds. The all-out effort to mobilize the Islamic world provided a windfall for the jihad, but came at the cost of a significant loss of control by governments over the origin and destination of funds.³⁵

“Mr. Director, I’m going to drown you in money. You ask for it and I’ll pay for it.”

- Congressman Charlie Wilson

Between 1979 and 1989 over \$3 billion in U.S. taxpayers’ money was sent to the mujahideen — an amount matched by the Saudis. Then, on August 2, 1990, the Iraqi invasion of Kuwait touched off the first conflict of the post cold war era. Once again, in a context of low oil prices, Saudi Arabia was called on to make a major financial contribution to the anti-Iraqi coalition. The financial networks set up at the time of the anti-Soviet jihad were kept in place. In Afghanistan, US financial aid slowed to a trickle, and by 1994, it had all but ceased.³⁶ The Soviet withdrawal from Afghanistan, far from bringing stabil-

ity, led the country into deeper chaos. In the words of Robert Gates, “We expected post-Soviet Afghanistan to be ugly, but never considered that it would become a haven for terrorists operating worldwide.”³⁷ In 1992, the communist regime in Kabul had fallen, and a civil war, pitting various Mujahideen warlords against one another, ensued. By that time, the United States, now preoccupied by developments in other parts of the world (such as the fall of the Berlin Wall and the disintegration of the Soviet Union) lost interest in Afghanistan. Financial flows were needed again. Islamic charities, some legitimate and other not, played a key role throughout the 1990s. Other networks, incubated during the Afghan jihad, became increasingly active, and new countries got involved.

Upstarts, Hedgers, & the Financial War on Terror

As Islamic politics grew more complex, the “privatization of foreign policy” attracted more players, giving extremism a new lease on life. Indeed, in an early form of “crowdfunding,” some Gulf financiers took to sponsoring extremist organizations either out of conviction, or as a way for malcontents to register their dis-

pleasure with their own governments.

In later years, two countries came to play very significant roles. Qatar, under the leadership of Hamad bin Khalifa Al Thani, who ruled between 1995 and 2013, stepped out of the shadow of Saudi Arabia, and came into its own. Eager to “punch above its weight”, it used its significant financial resources, as well as the reach of its media network Al-Jazeera, to win friends and influence people throughout the Islamic world and elsewhere. In Turkey, the rise of the pro-Islamic Justice and Development Party (AKP), in power since 2002 under the leadership of Recep Tayyip Erdogan, led to a renewed interest in the Islamic world. Both countries claimed that their sudden appearance on the regional scene, and the cultivation of a broad range of political parties, was motivated by a desire to maintain peace and stability in the region—a “zero problem” policy, whereas their critics argued that they were simply hedging their bets.

With the advent of the Arab Spring, however, their strategy evolved into one of taking sides. In Egypt, Turkey and Qatar were strong supporters of the Muslim Brothers and the Morsi government, while other regional players, Saudi Arabia in particular, who had opposed the Morsi regime, threw their consid-

The Itihadeya Protest on December 11, 2012 in the streets around the Presidential Palace. The streets were full of people upset about the Constitutional Referendum put forth by President Morsi, which would significantly expanded his presidential power and effectively eliminate any structural oversight of his decrees. Although he quickly annulled the decree that gave him expanded powers, the damage done to his relationship with the public was irreversible. He would be removed from office less than a year later on July 3, 2013 in a coup d'état led by his Defense Minister Abdul Fatah al-Sisi (Omar Kamel).



Photo by Omar Kamel

erable financial support behind the July 3, 2013 coup. Indeed, soon after the announcement of the destitution of Mohammed Morsi, Saudi Arabia, the United Arab Emirates and Kuwait announced a \$12 billion aid package to Egypt.

The United States reentered the fray following the August 1998 embassy bombings in Kenya and Tanzania, with new covert operations involving the supply and funding of anti-Taliban warlords, and more dramatically after the September 11, 2001 World Trade Center attacks.³⁸ Indeed, the “war on terror” that followed began with a financial strike when, on September 24, 2001, President George W. Bush, announced the “launch of a strike on the financial foundation of the global terror network.” A presidential order blacklisted 27 individuals and groups — “terrorist organizations, individuals, terrorist leaders, a corporation that serves as a front for terrorism and several nonprofit organizations.” The presidential statement made it clear that this was just a beginning: in the open-ended war on terror, many more financial attacks would be forthcoming. It was from the outset a global attack. Within days, the international community — through the G7, the United Nations, the European Union, the Financial Action Task Force, etc. — enlisted in the fight to “disrupt terrorist funding throughout the world.” Money was said to be the “oxygen” of terror and a huge apparatus was put in place to end terror funding, and by implication, terrorism.³⁹ But the tight control over global banking transactions, in particular through the systematic monitoring of bank transfers through SWIFT (Society for Worldwide Interbank Financial Telecommunications) and the globalization of anti-money laundering and terrorist financing did not put an end to terrorism, which rose five-fold since 2001.⁴⁰ The unintended consequence of these measures was that terrorist financing moved to cash and underground activities, and thus became more difficult to detect and combat.⁴¹

Conclusion

In the “final showdown” of the cold war,⁴² little consideration was given to how and to whom money and weapons were handed out. Mistakes made three decades ago kept being repeated, and the current war against the Islamic State (IS, a.k.a. ISIS, the Islamic State in Iraq and Syria, and ISIL, the Islamic State in Iraq and the Levant), provides a good occasion to revisit some of the mistakes in the hope that they will not be repeated again.

One lesson is that financial support can strengthen and even create a potential enemy, and that weapons could be turned against those who supplied them. Examples of these forms of blowback abound. Sophisticated weapons furnished by the United States to Iran’s *ancien régime* brought the forces of revolutionary Iran close to victory during the 1980–1988 war with Iraq. In turn, the fear of an Iranian victory brought Iraq a great deal of unlikely allies, ranging from the United States to conservative Persian Gulf oil monarchies. Yet barely two years after that war ended, Iraq invaded Kuwait, a country whose generous credits to Iraq were a crucial factor in winning the war. One of the Iraqi griev-

ances was that the Emirate had refused to forgive those loans, despite the fact that the Iraqi army had defended it, as well as the entire Persian Gulf, against the threat posed by the Iranian revolution.

How are funds allocated and disbursed? In the case of Afghan jihad, the sheer size of the windfall was bound to magnify the unavoidable waste, fraud and abuse. In a war-torn area where alliances were tangled and political agendas inscrutable, the process was particularly opaque. Every account has documented a bizarre free-for-all. Every warlord was on the take, though the favorite, Gulbuddin Hekmatyar, the most ruthless and fanatical of all, was the recipient of half the arms being supplied by the CIA.⁴³ As explained by Steve Coll, “The main intelligence agencies involved (Saudi Arabia’s GID, Pakistan’s ISI, and the CIA) began to ‘compartment’ their work even as all three collaborated with one another through formal liaisons. Working together they purchased and shipped to the Afghan rebels tens of thousands of tons of weapons and ammunition. Separately, they spied on one another and pursued independent political agendas.”⁴⁴ The amounts involved and the breadth of the recipients are mind-boggling: “The payroll had several tiers. A regional commander might draw an agency retainer of \$20,000 or \$25,000 a month in cash. A somewhat more influential leader might draw \$50,000 a month. A commander with influence over one or more provinces might receive \$100,000, sometimes more.”⁴⁵

“Playing the sectarian card and stirring up religious fanaticism may have brought short-term rewards, but it became clearly impossible to put the genie back in the bottle.”

Another important lesson concerns the consequences of indiscriminate bribing. It should have been obvious that while loyalty is often for rent, it is seldom for sale. Michael Scheuer, who served as the chief of the Bin Laden “virtual station” at the Central Intelligence Agency from 1996 to 1999, stated it forcefully: “Afghans can’t be bought off with bribes. Plying them with money usually guarantees that they will do the opposite of what the United States asks. Case in point: Despite offering millions in reward money, not a single Afghan has turned over a ‘high-value’ Taliban or al-Qaida target to U.S. forces.”⁴⁶ Indeed, one of the defining characteristics of many Northern Alliance leaders is that while they were on everyone’s payroll, their loyalty could not be counted on.⁴⁷

Just as in the days of the cold war, each camp provided strategic rents to its allies, and the “war on terror” reopened the floodgates: signing on to that war was enough to claim aid and assistance. Playing the sectarian card and stirring up religious

fanaticism may have brought short-term rewards, but it became clearly impossible to put the genie back in the bottle.⁴⁸ Before pouring money and weapons, governments would do well to ponder the consequences of shifting alliances and changing circumstances.⁴⁹

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Enough to Go Around?

Money Matters Complicate U.S. Strategic Rebalance to Asia-Pacific

BY **Leon Whyte / Richard Weitz**

Current State of the ‘Asia Pivot’

The U.S. Strategic Rebalance to Asia – also known as the “Asia Pivot” – has been a cornerstone of the Obama administration’s foreign policy since 2011. Hillary Clinton offered a detailed explanation of the concept in a 2011 Foreign Policy article.¹ The basic idea behind the Rebalance is that many U.S. core economic and security interests are increasingly centered in the Asia-Pacific region, so the United States needs to allocate more diplomatic, economic, military, and other assets towards the region.

The Strategic Rebalance would do just that. The Defence Strategic Guidance released by the Defence Department in January 2012 made supporting the rebalance a key Pentagon objective. The Obama Administration accordingly plans to increase the percentage of naval assets in the Pacific to 60 percent by 2020² in addition to stationing 2,500 Marines in Darwin, Australia, and 4 littoral combat ships in Singapore.^{3,4} Given the region’s economic importance, this makes sense. The Asia-Pacific region accounted for 40 percent of global economic growth in 2013. In 2012, the U.S. exports to the region totaled \$555 billion, which supported 2.8 million U.S. jobs.⁵

Then-Deputy Secretary of Defense Ashton B. Carter meets with Korea’s Minister of National Defense Kim Byung-kwan in Seoul, South Korea, March 18, 2013. The two met to discuss the rebalancing of U.S. forces to the Asia-Pacific region and as well recent provocative actions by North Korea (Glenn Fawcett, DOD).



The economic and security aspects of the rebalance policy are interconnected. The U.S. strategic presence in the region has contributed to the stability that has enabled the amazing growth of Asian economies over the past 60 years. As U.S. Deputy Secretary of Defense Ashton Carter noted in 2012: “If that (U.S.) security were ever to go away... all of the people in the Asia-Pacific region that have been lifted up into prosperity in the post-War period, would be set back significantly. The global economy would be set back significantly... that is partly why we are rebalancing our efforts in the region.”⁶ If the Rebalance works as promised, then the United States would continue to provide the region with security, which would in turn promote stability and continued economic growth, a significant win-win for the United States and its Asian partners.

However, U.S. economic weaknesses and the Budget Control Act of 2011 – which mandates cuts in U.S. government spending (known as “sequestration”) – have constrained the U.S. government’s ability to resource the Rebalance adequately and meet its regional security commitments.⁷ The sequestration process was deliberately devised to present the Congress with an unacceptable outcome if the members failed to balance the budget through a combination of tax hikes and targeted spending cuts. But the congressional compromise has failed to occur, and now sequestration is threatening to wreck havoc throughout the government with arbitrary percentage-driven spending cuts. Complicating matters further in the defense domain are the Taliban’s resilience in Afghanistan and the stunning emergence of the Islamic State in Iraq and Syria. During the initial planning and unveiling of the Rebalance, the United States assumed it would be possible to shift more resources to Asia as it curtailed its commitments in the Middle East and South Asia,⁸ yet U.S. engagement in these areas is steady or growing. New challenges have also emerged in Europe due to Russian aggression against Ukraine.

Among other steps, the Obama Administration will need to find common ground with the new Republican-controlled Congress to reassure allies that U.S. strategic commitments will be matched with U.S. means based on strategic considerations, rather than domestic partisan battles.



Ships and submarines participating in exercise Rim of the Pacific (RIMPAC) 2012 on July 27, 2012 sail in formation in the waters around the Hawaiian islands. Twenty-two nations, more than 40 ships and submarines, more than 200 aircraft and 25,000 personnel are participating in the biennial RIMPAC exercise from June 29th to August 3rd, in and around the Hawaiian Islands. The world's largest international maritime exercise, RIMPAC provides a unique training opportunity that helps participants foster and sustain the cooperative relationships that are critical to ensuring the safety of sea lanes and security on the world's oceans. RIMPAC 2012 was the 23rd exercise in the series that began in 1971(Chief Mass Communication Specialist Keith Devinney, U.S.

Reassuring Allies During Austerity

In 2011, President Barack Obama told the Australian parliament that “reductions in U.S. defense spending will not – I repeat, will not – come at the expense of the Asia-Pacific.”⁹ U.S. Secretary of Defense Chuck Hagel has reaffirmed this commitment on several occasions, including at the AUSMIN talks in Sydney in June 2014, when Hagel signed the Forces Posture Agreement that will see US military assets expand in Australia for the next 25 years.¹⁰

This reassurance is important, as countries in Asia have come to depend on the United States to provide security and stability in the region. If they believe the United States is no longer capable of fulfilling this role, the chances of Asian states engaging in destabilizing regional arms races increases.¹¹ In 2012, Asia outspent Europe on defense for the first time, and that ratio is increasing.¹² South Korea announced a 5.3 percent increase in defense spending for 2015, which is the highest rate of de-

fense growth since 2011.¹³ In Japan, the Abe Administration is prioritizing Japanese defense capabilities, as evidenced by its submission of the largest ever defense budget request this year.¹⁴ This increased defense spending can trigger a regional security dilemma. This is especially true in the case of Japan, which has historical antagonisms with both Korea and China dating from Japan's colonial period and World War II-era atrocities.¹⁵ However, China spends more on its military than Japan, South Korea, Taiwan, and Vietnam combined, and is continuing to increase military spending.^{16,17}

The U.S. defense cuts are coming at a time when regional tensions are high. South Korea faces a provocative North Korea. Since 2010, North Korea has: sunk the Cheonan, a South Korean submarine, killing 46 seamen; shelled Yeonpyong, a South Korean Island, killing four South Koreans; and threatened to turn Seoul into a sea of fire.¹⁸ China's assertive actions in the East China Sea have presented a significant strategic threat to Japan. Tensions are centered over competing territorial claims over what the Japanese call the Senkaku Islands. In November

2013, China without warning declared a new Air Defense Identification Zone (ADIZ) in the East China Sea that encompassed the disputed islands and overlapped both Japan and South Korea's previously established ADIZs.¹⁹ In the South China Seas, there is threat that territorial disputes between China and other countries will erupt into conflict.²⁰

Budget Cuts and Sequestration: What's at Stake?

In 2014, Katrina McFarland, the U.S. Assistant Secretary of Defense for Acquisition, declared that due to budget constraints "the pivot is being looked at again, because candidly it can't happen."²¹ The next day, MacFarland withdrew her statement, but there are genuine concerns about U.S. ability to continue strengthen commitments to Asia while managing other worldwide crises as defense resources shrink. For example, despite his many assurances to Asian allies about the rebalance policy, Hagel warned in 2014 that, if the sequestration cuts continued as planned, the military would become a "hollow force... not capable of fulfilling assigned missions."²² Under current plans, the United States will reduce its military budget by \$487 billion in planned cuts over the next ten years on top of a potential additional \$500 billion in cuts mandated by sequestration.²³ A further concern is that the U.S. military will have to reallocate resources to carry out new missions in Iraq, Syria, Europe, and other locations.²⁴

Another important aspect of the defense cut is the plan to reduce the overall size of the active duty U.S. Army to fewer than 450,000 soldiers, which would be its smallest size since before WWII.²⁵ For Seoul, these reductions are of particular concern because any major Korean contingency in the event of a North Korean invasion or collapse would require a massive ground force to stabilize the peninsula.²⁶ For Japan and South East Asian countries, the U.S. Navy presence is a major concern since much of the disputed territory in the region is maritime. Even if the Navy moves 60 percent of their fleet to the Pacific by 2020, continuing current cuts may result in a smaller force. For example, the 2015 Department of Defense budget reduced funding for U.S. Navy shipbuilding from \$17.9 billion to \$14.4 billion.²⁷

The U.S. Air Force, which would be important in any conflict in the Asia-Pacific, has suffered critical budget cuts relating to its readiness, force structure, and modernization accounts.²⁸ These defense cutbacks has led the head of U.S. Pacific Command, Adm. Locklear, to state that "The ability for the services to provide the type of maritime coverage, the air coverage of some of the key elements that we've historically needed in this part of the world for crisis response, have not been available to the level that I would consider acceptable risk [due to recent budget cutbacks]," a response bound to leave U.S. allies uneasy as tensions remain high in East Asia.²⁹ U.S. efforts to revitalize the U.S. nuclear weapons establishment or develop new non-nuclear technologies, such as through the Pentagon's new Offset Strategy, are also constrained by limited funding.

Rebalancing the Rebalance

It is normal for countries to decrease defense spending after ending wars. In addition, in a period of American austerity, it is beneficial for American allies to contribute more, especially rich ones like South Korea and Japan. Yet, the United States must remain the dominant security force in Asia, as its continued presence as an offshore power is less likely to ignite a security dilemma than, for example, a rapidly rearming Japan. Asia's continued peace and prosperity requires a secure and stable environment, which only the United States is currently able to provide. Sequestration under the Budget Control Act is a blunt tool that reduces U.S. ability to plan strategically. Currently the United States is at an impasse where the amount of funding requested for FY 2015 does not meet stated U.S. national security strategy laid out in the 2014 Quadrennial Defense Review.³⁰ The Bipartisan Budget Act in 2013 reduced the effects of sequestration on defense spending for FY2014 and FY2015 by about \$30 billion.³¹ Still, additional legislation is needed to prevent the cuts from returning in full force in FY2016.

President Obama and the new Congress should make funding the Strategic Rebalance a bipartisan priority. There is some hope that greater clarity and cooperation between the Obama administration and Congress, the 2015 National Defense Authorization Act included a new provision that requires the DOD to submit an Asian strategy report to Congress.³² The Congress should use this report as an opportunity to be more involved with the Rebalance strategy because without their involvement it cannot be funded adequately. The U.S. national interest and a well-planned strategy should guide the "Asia Pivot," not the arbitrary and irrational dictates of the Budget Control Act of 2011.

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Sanctions & Economic Mismanagement

Interpreting the Iranian Currency Crisis, 2010-2012

BY **Jessica Knight**

Introduction

In October 2012, the Iranian rial earned the unwelcome distinction of the world's least valued currency. It had lost more than 80% of its open market value in the previous two years, crashing from 9,800 to 37,000 rials (IRR) per U.S. dollar (USD). As the rial lost value, demand for more reliable hard currencies surged until it far exceeded the Central Bank of Iran's (CBI) official supply. The widening spread between the official and black market rates reinforced loss of public confidence in the rial and perpetuated the cycle of devaluation.

Many western analysts, taking their cue from U.S. officials, claimed this devaluation proved the efficacy of international sanctions.¹ The Bloomberg editorial board heralded the rial's "death spiral" as "the first clear sign that we're on a path to victory."² The Cato Institute proclaimed the arrival of hyperinflation and projected the rate to double every 38 days.³ Forbes termed this imminent hyperinflation "a weapon of mass destruction" and likened Iran to Zimbabwe and Weimar Germany.⁴ Such reputable outlets as CNN, the Boston Globe, BBC News, the New York Times, and the Wall Street Journal offered variations on the same theme: because of sanctions, Iran wavered on the brink of financial collapse.⁵

These analysts badly misjudged the currency crisis. Two years later, the rial has stabilized, albeit at a devalued rate. Inflation has dropped 50% in the last year, and the economy has pulled out of recession, with estimates of economic growth between 2.9% and 4.6%.⁶ Iran may be feeling the pain of sanctions, but it has not collapsed into the hyperinflationary death spiral that so many analysts confidently predicted. Their errors derived from superficial analysis, classic confirmation bias, and a misunderstanding of the dynamics of the Iranian foreign exchange market.

In reality, the complex interplay of several related factors prompted the crisis: economic mismanagement under President Mahmoud Ahmadinejad, public loss of confidence in the rial, and the impact of the 2012 sanctions on inflationary ex-

pectations. Furthermore, because of the particular relationship between Iranian state structures and its isolated economy, the impact of the currency crisis was restricted to a very small segment of the economy. This allowed the government to resurrect its multiple exchange rate system to subsidize essential goods.

Despite drastic reactive measures, the government quickly stabilized the rial and adapted the new situation to its advantage. Iran does not seem to have been at any immediate risk of financial collapse. In fact, the ruling elite has strengthened its economic and political positions as a result of the devaluation.

Historical Development of the Currency Crisis

The rial's abrupt depreciation from 2010-2012 overshadowed a long history of currency decline. In 1980, the nascent Islamic Republic plunged into economic travail during its ruinous eight-year war against Saddam Hussein. Military imports and capital flight propelled high demand for foreign exchange, despite a wartime drop in dollar-denominated oil exports. In response, the government instituted a system of multiple exchange rates and intense capital controls. By the end of the war, Iran had twelve different IRR/USD exchange rates, all overvalued. This abstruse system stabilized the rial but, over time, led to macroeconomic distortions, budget deficits, pressure on foreign exchange reserves, and corruption.

The postwar administration of Ali Akbar Hashemi Rafsanjani (1989-1997) gradually reduced the number of exchange rates, but unification carried high transition costs for the fragile economy. For example, in March 1993, Iran briefly eliminated all but one official exchange rate that coexisted with a parallel open market rate (legal, but outside the banking system). The official rate was a managed float based on the open market; however, by December, unexpectedly low global oil prices and expansion-

ist fiscal policy rendered it unsustainable. Inflation skyrocketed from 22.9% in 1993 to a high of 58.8% in 1995, and Iran subsequently reverted to multiple rates.⁷

Lasting exchange rate unification was not feasible until 2002, under reformist president Mohammad Khatami (1997-2005). The CBI adopted a managed float at IRR 7,900 per USD 1. This reflected the rial's steady depreciation since the revolution: between 1978 and 2001, the official rate fell from IRR 70 to IRR 1,750 per USD 1, while the open market rate dropped more drastically from IRR 100 to IRR 7,920.⁸

The CBI could maintain this managed float at relatively low cost because it controlled the flow of dollars into Iran. The rial was not fully convertible: it held no value on global exchange markets, and it was used almost exclusively inside Iran. Crude oil exports were the primary mechanism by which dollars entered the Iranian economy. The petroleum industry is state-owned and operated, with the CBI acting as a clearinghouse for almost all transactions. As a result, the CBI controlled the domestic supply of dollars and effectively manipulated it to prop up the rial.

Traditionally only individuals and import companies that dealt in "essential goods" or had government connections (often these

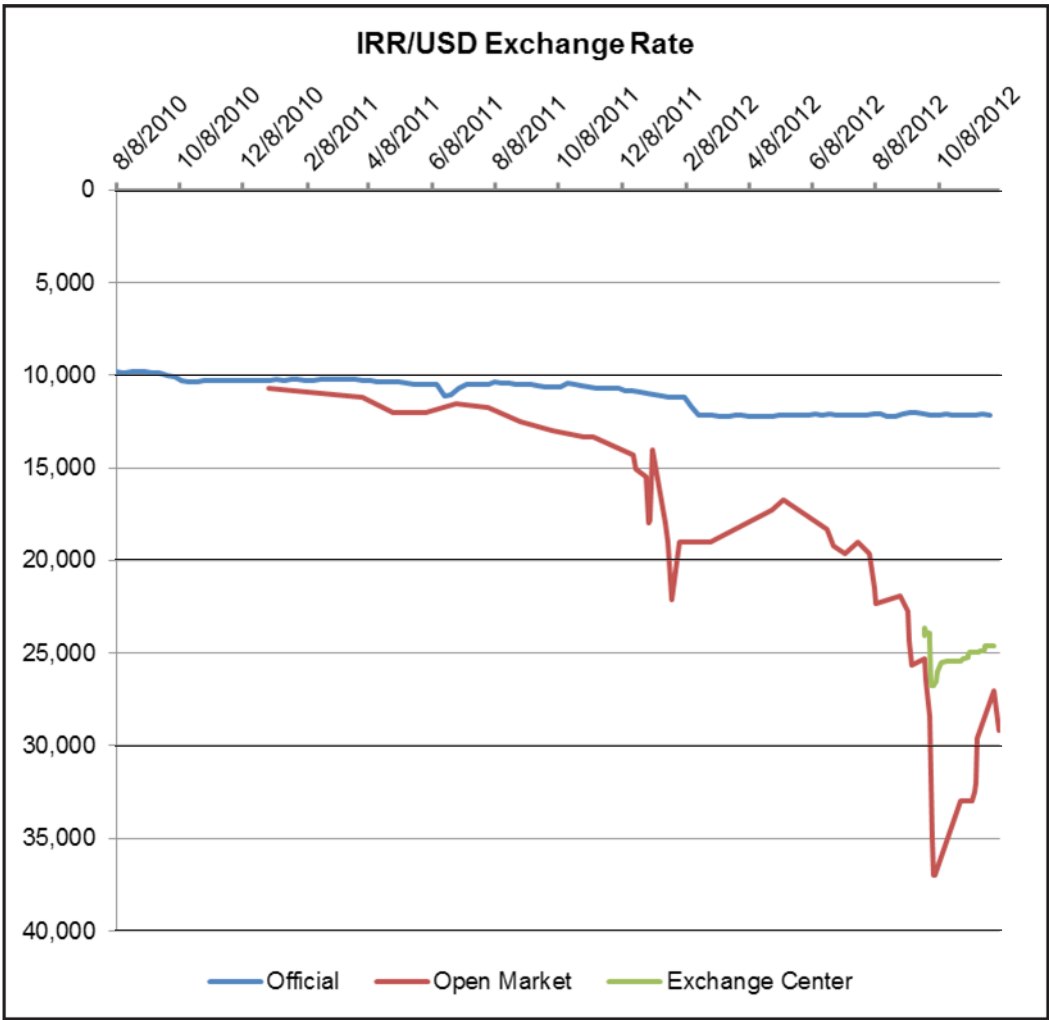
were the same entities) could readily access large sums of dollars. A thriving black market for dollars emerged in the Tehran bazaar to handle excess demand. Black market demand derived primarily from other private sector entities and anyone wishing to travel or pay tuition abroad – not nearly enough to exert significant pressure on the rial. As long as the spread between the official and black market rates remained negligible, the government tolerated unofficial currency trading in the bazaar.

However, the turn of the decade saw rising volatility in Iranian currency markets. September 2010 marked the first time since the 2002 currency reform that the black market rate dipped markedly below the official rate. Between September 2010 and October 2012, the low point of the crisis, the Iranian rial lost almost 80% of its open market value, falling from around IRR 9,800 to IRR 37,000 per USD 1 (see Figure 1).

In late September 2012, the CBI abandoned the managed float and resurrected a version of the old postwar multiple exchange rate system. The CBI categorized goods by relative economic importance and assigned different exchange rates to each category:

- 1. Official (Reference) Rate: a peg against the dollar at IRR

Figure 1: Sourced from Author calculations and various open source reports.





Bazar-e Bozorg, Isfahan, October 2007. The herringbone bond of the masonry domes gives the structure an almost woven quality. This is in the northernmost, poorer part of the long bazaar. The bazaar consists of several covered streets, the longest of which connects imam square with the friday mosque 1½ winding kilometers away (seier+seier, Flickr.com).

12,260 per USD 1. The most privileged rate applied only to essential goods, such as food and medicine.

2. Exchange Center (Non-Reference) Rate: purportedly a managed float against the dollar, set daily by the CBI at 2% below open market.⁹ It was used to import other priority goods, such as livestock, metals, and minerals.¹⁰

3. Open Market (Black Market) Rate: free float against the dollar.

Causes of the Crisis

At the height of the crisis in early October 2012, President Mahmoud Ahmadinejad blamed sanctions for the chaotic currency markets. “Are these currency fluctuations because of [domestic] economic problems?” he asked reporters in Tehran. “The answer is no. Is this because of government policies? Never. . . it’s due to psychological pressure. It’s a psychological battle.”¹¹ U.S. officials gladly accepted the blame. A U.S. State Department spokesman claimed that month: “[The rial’s devaluation] speaks to the unrelenting and increasingly successful international pressure that we are all bringing to bear on the Iranian economy.”¹²

This expedient causal line from sanctions to currency collapse does not stand up to scrutiny. No single factor caused the currency crisis. Rather, it was the interplay of three related factors: economic mismanagement; loss of public confidence in the rial; and the indirect impact of sanctions on inflationary expectations.

Economic Mismanagement

When Ahmadinejad ran for president in 2005 and 2009, he promised a welfare-oriented economic plan that included an overvalued rial, expansionist fiscal policy, and low interest rates. In essence, his philosophy was to focus Iran’s considerable oil revenue on the poor. But these policies reflected his populist agenda rather than sound economic principles. Ahmadinejad brazenly disdains economics; he has stated publicly, “I pray to God I never know about economics,” and claimed to take economic policy advice from his local butcher.¹³ His fiscal profligacy directly undermined the Iranian economy.

Iran experienced record inflation from 2005 to 2012. Official reports comparing food prices show year-on-year increases of 42% for dairy products, 47.5% for red meat, 29% for rice, and 92% for vegetables from 2011-2012.¹⁴ The owner of a chicken shop in southern Tehran recounted this price volatility:

Yesterday, I had some orders from some regular customers. So I sold them chickens for 50,000 rials each, but when I went to buy the chickens today, the price had spiked 5,000 rials overnight. I had to pay 55,000 rials for each chicken, so I lost some money. It would be fine if this was a one-time thing, but it keeps happening. The prices, they’ve fluctuated so much the last couple of months.¹⁵

Iran's inflation stands out even more starkly when compared with the economies of its major trading partners, which only saw year-on-year increases of 2-4%. These inflation differentials alone indicate that the rial should have lost nearly 90% of its value between 2005 and 2011.¹⁶ Instead, the government continued its practice of overvaluing the rial to benefit importers and symbolize strength against the West. This defied not only economic prudence but also the explicit terms of Iran's Fourth Economic Development Plan (2005-2010), which mandated exchange rate adjustments to account for foreign inflation.¹⁷

Ahmadinejad exacerbated the problem by holding nominal interest rates artificially low – well below the rate of inflation. In 2008 Tahmasb Mazaheri, the second CBI governor under Ahmadinejad, cautioned that this policy could spark hyperinflation, but Ahmadinejad dismissed his warnings.¹⁸ When the rial began its steep descent in late 2010, interest rates were dangerously low (around 13% annually on short term deposits). In April 2011, the CBI inexplicably lowered rates even further (to about 12%). Then-CBI Governor Mahmoud Bahmani promised the cut would “decrease the final prices of products and control and manage imports,” over the furious protest of many private banks.¹⁹

Into this chaos, Ahmadinejad introduced several ill-conceived populist programs. The massive Maskan-e Mehr (Goodwill Housing) project was, in many ways, the signature program of Ahmadinejad's administration. Introduced in 2007, the Mehr housing project targeted a severe shortage of housing for Iran's working class. Ahmadinejad provided free government land to developers in order to build two million affordable housing units. Eligible first-time homeowners who could not otherwise access necessary credit were granted 99-year mortgages guaranteed by the state.

As a populist program, the Mehr housing project backfired. Iranian banks had granted loans worth over IRR 100 trillion (USD 10.2 billion) to first-time homeowners by January 2011, and the government itself borrowed upwards of IRR 400 trillion from the CBI to finance the program.²⁰ Granting extended lines of credit had the added effect of fueling inflation. As rising prices made these ventures unprofitable for developers, many were abandoned midconstruction, without access to clean water, heating, and sewage. The government loans could only partially cover the cost of a mortgage. Homeowners failed to make payments, and the government was left holding all the bad debt.²¹

Subsidy reform, though prudent in concept, fell victim to flawed implementation. The Targeted Subsidies Reform Act, passed in March 2010, phased out Iran's extensive system of indirect subsidies on energy and other basic goods. The high cost of these subsidies had become unsustainable, estimated at 25% of total GDP in 2009 (USD 335 billion).²² Ahmadinejad decided to compensate the population for soaring post-reform prices with monthly direct cash transfers of IRR 455,000, which totaled nearly USD 2.7 billion per month.²³

The Majlis (Iranian parliament) proposed using half the revenue from subsidy cuts for these compensatory payments and half to support domestic producers. Instead, Ahmadinejad dropped the producer support and increased the cash transfers in a misguided attempt to mitigate political backlash. The abrupt switch to non-subsidized prices, combined with excess liquidity from the cash transfers, skyrocketed inflation to 30-45%.²⁴

Beyond inflation, expansionist programs like these cash transfers and the Mehr housing program also drove up the budget deficit. The cost of the cash transfers far outstripped any government savings from subsidy reform. During Iranian year 1391 alone (March 2012 – March 2013), the government saved IRR 280 trillion but paid out IRR 420 trillion in these transfers.²⁵ This shortfall had to be financed out of the general budget. According to Minister of Economy Ali Tayeb-Nia, Iran had accrued a budget deficit of IRR 160 trillion by February 2012. Government expenditures in the preceding year exceeded revenue by a staggering IRR 96 trillion, which amounted to 45% of the total budget.²⁶

The government turned to a number of questionable sources to fill this gap: funds previously allocated to other uses, holdings of the Oil Development Fund and National Development Fund, and CBI loans. The CBI provided the necessary rials for these loans by selling foreign exchange on the black market. This arbitrage provided greater numbers of rials for increasingly fewer petrodollars. According to Ahmad Tavakkoli, Majlis representative from Tehran and head of the Majlis Research Center, the administration had earned IRR 110 billion in this way by September 2012.²⁷

Arbitrage on a government scale has precedent in Iran. The CBI admitted to selling hard currency on the black market in the early 1990s under similar circumstances: multiple exchange rates, high inflation, and a mounting deficit. That likely accounts for the unexplained increase in the share of “other revenue” in the annual budget from an average of 14% during the years preceding and during the Iran-Iraq War (1978-1988) to an average of 36.2% in the four years after the war ended (1989-1992).²⁸ But debt monetization is shortsighted, especially in times of fiscal turmoil. It increases the money supply and perpetuates the cycle of devaluation.²⁹

Loss of Confidence

The cumulative result was a loss of public confidence in the rial. As rial accounts paid interest far below inflation, Iranians rushed to move their savings into non-rial assets, such as gold, foreign exchange, and real estate. Public anxiety steadily weakened the rial, so that the new round of sanctions in 2012 fell on a vulnerable environment of high inflationary expectations and low confidence in the currency.

Government mishandling of the crisis only confirmed fears and further eroded confidence, especially after the low point in 2012. The CBI's initial response was characterized by empty promises,

insufficient action, and coercion. For example, the CBI expected the new Exchange Center not only to provide a mid-tier rate for essential goods, but to stabilize the open market rate as well. It had the opposite effect. The rial lost nearly 40% of its value in the three months preceding the opening of the Exchange Center; it lost that much again in the week after.³⁰

To a wary public, the creation of the Exchange Center confirmed that the CBI lacked sufficient hard currency reserves to meet rising demand. Suspicion trumped the CBI's promise to sell 14.5% of oil export proceeds and 20% of its sovereign wealth fund at the Exchange Center.³¹ Further, the Exchange Center rate was fixed at 2% below the open market rate. With this privileged second tier now linked to the free-falling market rate, importers of affected goods anticipated future price increases.³²

The government soon turned to more heavy-handed tactics. In early January 2012, all nonofficial currency trading was banned.³³ Iranian security forces shut down the Tehran bazaar multiple times over the next several months. Currency speculators were arrested for trading dollars at less than the official rate, accused of "acting in line with the nation's enemies," and threatened with execution.³⁴ SMS text messages with the words "dollar" in English or Farsi or "foreign currency" in Farsi were censored.³⁵ By September 2012, the CBI had stopped reporting the value of the rial and forced the handful of private Iranian currency-tracking websites to do the same.³⁶ Far from calming the markets, however, coercion and censorship further undermined public confidence by suggesting the government had something to hide.

Contradictory and confusing statements by Iranian officials compounded the sense of uncertainty. On the same day that Ali Larijani, speaker of the Majlis, said foreign exchange reserves were low, his deputy, Mohammad Reza Bahonar, claimed that reserves were more than sufficient to support the rial.³⁷ Mehdi Ghazanfari, the Minister of Industry, Mines, and Commerce, blamed "non-economic perpetrators" for the currency fluctuations and publicly called for the intervention of Iranian security forces.³⁸ Ahmadinejad himself bizarrely hinted at currency sabotage by a cabal of 22 unnamed internal enemies.³⁹

International Sanctions

Thus, by 2010 Iran had a grossly overvalued rial and expanding domestic liquidity, thanks to years of economic mismanagement. The Iranian people were rapidly losing confidence in their currency. The rial was vulnerable, and international sanctions provided the catalyst for swift devaluation. The first sharp drop, when the rial declined 20% against the dollar in one week in September 2010, coincided with news that banks in the United Arab Emirates had stopped processing financial transfers to Iran.⁴⁰ Then, three major sanctions-related events occurred in the first half of 2012:

1. In January, the United States intensified sanctions against the Iranian banking sector, targeting the CBI and all financial insti-

tutions that transacted with it.⁴¹ This impeded the export of oil, because foreign importers usually dealt directly with the CBI.⁴²

2. Also in January, the European Union (EU) announced new sanctions that prohibited the import of Iranian oil and insurance of Iranian tankers. This prevented the purchase and transport of Iranian crude by Asian oil refiners (e.g. in South Korea, Singapore, Turkey), which were otherwise willing to defy sanctions.⁴³ Shipments could continue only if importing governments offered sovereign insurance guarantees, as China and Japan proceeded to do, or if Iranian exporters used their own tankers and insurance. However, neither of those workarounds could handle the volume of previous oil sales, especially since a number of Iran's largest tankers already were in use as floating storage units.⁴⁴

3. In March, Belgium-based financial clearinghouse SWIFT stopped service to Iranian banks, including the CBI.⁴⁵ SWIFT, the world's largest interbank electronic payment system, plays a crucial role in efficient international trade. In 2010 alone, Iranian banks had used SWIFT to make more than two million cross-border payments, most of which were remittances of payment for oil and other exports.⁴⁶ Iran's exclusion from SWIFT was an unprecedented blow to its ability to conduct international trade, and it imposed large additional transaction costs.

The effect of sanctions on inflationary expectations is undeniable. Iranians scrambled to sell their rials; in an environment of rapidly fluctuating prices and general economic uncertainty, even ordinary Iranians read further sanctions as a danger to their currency. But those same sanctions, imposed on a well-managed Iran, would not have had such a devastating effect. Iran could have worked much earlier to curb inflation by raising interest rates and exercising fiscal restraint. Leaders could have harnessed the benefits of subsidy reform. Recognizing the dangers in an overvalued rial, they could have prepared for an orderly realignment of the exchange rate. Any of these measures would have mitigated the impact of sanctions on the currency in 2012.

Absent sanctions, the rial would not have fallen as far or as fast. But the underlying vulnerabilities took root in decades of ill-conceived economic policy and Ahmadinejad's blinding populist agenda.

Severity of the Crisis

Most contemporary analysis not only attributed far more to the potency of sanctions than was warranted but also wrongly predicted total financial devastation. Iran certainly experienced a major currency devaluation starting in 2010, and the government was forced to adopt drastic reactive measures. But the economy was not in imminent danger of collapse.

Part of the fallacy derived from faulty historical comparisons. The Iranian experience in 2010-2012 differed from the dramatic devaluations that preceded financial crises across Asia in the late

1990s or in Argentina in 2001. In Thailand, for example, devaluation of the baht affected all prices because foreign trade and investment played a significant role in the economy and all foreign exchange traded at the same rate. Compounding the problem foreign debt repayments. Western countries had invested heavily in Asia through the 1990s. As a result, Thailand amassed substantial dollar-denominated debt, which it was forced to repay using the free-falling local currency. This led to default and plunged Thailand into deep economic crisis.

In contrast, a devalued rial impacted a relatively small sector because of the isolation of the Iranian economy. Ahmadinejad addressed this phenomenon in a 2012 speech: “Everyone is aware that foreign trade and commerce don’t have a very high share in the Iranian economy. . . the number of U.S. dollars being exchanged in our country is not that big.”⁴⁷ Crucially, the government already controlled almost all foreign exchange through the state-owned petroleum industry. The CBI did not need to print or buy foreign exchange at crippling cost to finance its expenses. It simply could sell part of its dollar holdings at a much lower rate, as it did through the multiple exchange rate system.

Most Iranians lived well below the median income level and could only afford to buy essential goods (e.g. food, fuel, medicine) using rials. Under the multiple rate system, these goods were imported at the official rate – that is, implicitly subsidized. In this way, most Iranians were protected from the full deleterious effects of the crisis. Hardship was concentrated in Iran’s upper-middle class, composed of people working in the marginalized private sector who had built up savings and could afford to travel or educate their children abroad. These nonessential goods and activities felt the full effect of devaluation because they were relegated to the open market – that is, implicitly taxed.

Furthermore, Thailand in 1997 had essentially zero foreign exchange reserves to defend the baht. It was forced to shift abruptly from a fixed rate to a free float against the dollar, triggering a drastic fall in the baht’s value. Iran, on the other hand, held extensive reserves to defend the official rate until the situation stabilized.⁴⁸ Iran earned around 47% of its total oil income of the last 103 years between 2005–2012 and, according to official figures, pulled in USD 166 billion in 2011 alone.⁴⁹ Even with a healthy skepticism of self-reported economic data, the International Monetary Fund estimated that Iran had over USD 100 billion in foreign exchange reserves in 2012.

Far from heralding financial collapse, the currency devaluation ushered in a new era of government control of the economy. The government tightened its grip on prices and foreign exchange supply through the multiple rate system. Ruling elements, especially in Ahmadinejad’s inner circle and the Islamic Revolutionary Guards Corps (IRGC), enriched themselves. Arbitrage between the official and open market exchange rates earned vast sums for individuals, as well as banks and government entities.

For example, the IRGC used its access to privileged currency rates to purchase high-demand nonessential goods at a dis-

count, which it smuggled into Iran and resold for a significant profit. The IRGC manages security along borders, at international airports (e.g. Imam Khomeini) and seaports (e.g. Qeshm and Kish), which grant control over major trade centers. It also operates so-called “invisible jetties” along the Persian Gulf and Indian Ocean coastlines to facilitate the import and export of smuggled goods.⁵⁰

By design, the shift to multiple exchange rates in September 2012 drastically increased the cost of nonessential imports, including cars. The resulting scarcity fueled black market demand, driving up potential profits for smugglers. For this reason, the number of luxury cars imported in Mehr 1391 (22 September – 21 October 2012) skyrocketed almost 2000%, from 200 to 3,900.⁵¹ The average price of each car sold that month rose 60%, from USD 21–23,000 to USD 35,000.⁵²

To maximize profits, smugglers illegally purchased the cars at the official rate, using subsidized dollars earmarked for essential goods. The scale of this corruption is astounding. Iranian importers had misused around IRR 117 billion in this way as early as 4 November 2012 – less than two months after the introduction of the multiple exchange rate system.⁵³ According to Nader Ghazipour, a Majlis representative from Urumiyeh and member of an investigatory committee, the list of companies and officials involved was several pages long and implicated “high-ranking government officials” from the Ahmadinejad administration and

Bazar-e Bozorg, Isfahan, October 2007. This vendor continues to man his stall late into the night selling everything from textiles to fruit (seier+seier, Flickr.com).



several “quasi-governmental” companies – most likely IRGC-owned.⁵⁴

Furthermore, the subsidized dollars used to purchase these cars appear to have been designated for medical imports. Through 2011–2012, Iran experienced a shortage of critical medical supplies, including both drugs and equipment. The official regime line was to blame the shortages and resulting hardships on sanctions.⁵⁵ However, in August 2013, CBI governor Mahmoud Bahmani confirmed that unnamed organizations “received currency at the [reference] rate for importing 83 ships loaded with medicine and essential goods, but only eight of them were loaded with medicine and essential goods. The other 75 contained luxury items [i.e. cars].”⁵⁶

In other words, not only had corrupt actors seized the chance to smuggle high-demand expensive cars at the official rate, but their actions contributed to the scarcity of medicine and other essential goods needed for a desperate population. This is just one way the IRGC and others exploited the currency system to tighten their economic grip and generate enormous personal and institutional profits.

Such centralized economic control further translated to enhanced political power. Corrupt and questionable practices – such as arbitrage in exchange markets to fund budget deficits – helped the Ahmadinejad administration avoid catastrophic financial problems and even mitigate some of the pressure of sanctions. Profits from these schemes helped offset revenue losses from sanctions on the petroleum industry. The middle class, weakened economically and politically by the crisis, would be even less able to protest the regime than during the brief Green Movement of 2009. Wealth begets influence, especially in a corrupt, opaque political system; thus, the IRGC in particular shored up its position against domestic challengers, such as current President Hassan Rouhani.

Conclusion

The rial depreciated significantly in the open market between 2010 and 2012, culminating in an abrupt drop to an all-time low of IRR 37,000 per USD 1. To many Western observers, this indicated that sanctions had caused a full-blown financial crisis and foretold economic collapse. This myth held a powerful appeal for those opposed to Iran’s nuclear ambitions. It offered irresistible hope that Iran would soon be forced, out of sheer desperation, back to the negotiating table.

The true story was more complex and much less auspicious. Since the 2002 currency unification, a succession of Iranian administrations had deliberately overvalued the rial. Under Ahmadinejad, this combined with a number of other populist policies to severely weaken the economy and stoke massive inflation. Iranians rapidly lost confidence in their currency and began to move their wealth into non-rial safe havens, further driving down its value. The announcement of additional trade

and banking sanctions triggered a precipitous currency devaluation in the open market. While the value of the rial would not have fallen so suddenly absent sanctions, it is not accurate to consider sanctions the cause of the plunge. As an Iranian economics professor put it, “I do not deny the effect of sanctions, but the weight of mismanagement is heavier.”⁵⁷

Because of the particular relationship between Iranian state structures and its isolated economy, the impact of the currency crisis was restricted to a very small segment of the economy. The government resurrected its postwar system of multiple exchange rates to subsidize essential goods. As a result, the brunt of the devaluation was felt only by those fortunate enough to want to conduct business outside Iran or send their children to school abroad. Government actors may have had to scramble in the initial aftermath of the currency drop, but they quickly stabilized the rial and adapted the new situation to their personal gain.

For many Iranians, the election of Hassan Rouhani as president in June 2013 represented hope of escape from this downward economic spiral. Rouhani presented himself as a rational leader, whose government of “hope and prudence” would take the necessary steps to restore stability. His early policies sought to combat Ahmadinejad’s legacy of corruption, economic mismanagement, and abrasive foreign policy – but this is easier said than done. Even if Rouhani develops sound economic plans for reform, he will face significant political challenges to their implementation. Powerful domestic actors, including the IRGC and some of his own ministers, have both financial and political interests in opposing broad reform.

Rouhani’s standing in the government is increasingly tenuous, as he fields criticism from both conservatives and frustrated reformers. Supreme Leader Ali Khamenei is giving him space to explore the potential for sanctions relief through negotiations and, so far, has reigned in the challenges from the right. Yet Khamenei’s support for the president is neither unreserved nor guaranteed to continue indefinitely.⁵⁸ By permitting the negotiations but voicing pessimism about their efficacy, Khamenei has carefully positioned himself to claim credit (in case of success) or to abandon Rouhani to his fate (in case of failure). In many ways, Rouhani has staked his presidency on the success of these negotiations in propping up the economy.

The prospects for lasting reform in the currency markets are bleak. In a lecture last March, economist Mohsen Renani of the University of Isfahan argued that the Iranian economy has reached “a point of singularity,” brought about by more than forty years of continued double-digit inflation, weak growth, high unemployment, and an atmosphere of extreme uncertainty.⁵⁹ Unless the Rouhani administration can transcend severe political pressure and develop wise, conservative economic policies, Iran might face yet another perilous crisis.

1. It is important to note that not all analysts fell into the same errors. Both the *Washington Post* and the *Christian Science Monitor*, for example, published articles that acknowledged the role of domestic eco-

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Embattled Superpowers

BY **Dr. John H. Maurer**

On the eve of the Second World War, the noted journalist John Gunther could still maintain that: “Great Britain, as everyone knows, is the greatest Asiatic power.”¹ The British Empire in Asia controlled a vast territory and large population, sweeping in a great arc from New Zealand and Australia in the South Pacific, to Southeast Asia and South China, and on to India and the Middle East. Britain stood as a superpower with economic interests and security commitments stretching around the globe, much as the United States stands today.

That position of leadership, however, was endangered. The emergence of major new industrial great powers was transforming the international landscape. These challengers, as they converted their growing economic strength into military power, confronted Britain’s leaders with uncomfortable strategic choices. In Asia, one of those rising challengers, imperial Japan, posed a dangerous threat to Britain’s standing as a world power after it embarked on a policy of expansion.

We know the outcome of Japan’s challenge: war and the catastrophic breakdown of Britain’s standing in Asia. The collapse of British power was in part brought about by dynamic changes in technology and the lethality of modern weaponry, particularly the advent of naval aviation, which shifted the naval balance in Japan’s favor. On the eve of war, Britain sought to deter Japan by forming a naval force in the Pacific, known to history as Force Z, consisting of the battleship *Prince of Wales* and battle cruiser *Repulse*. Even as Force Z steamed eastward, the Admiralty could spare none of its aircraft carriers, to protect it from air attack. Nor did the Royal Air Force have enough modern aircraft based in the Far East to offer adequate protection for Force Z. Britain’s inability to control the skies meant the Royal Navy could not command the seas, and this permitted the Japanese to land ground forces in Malaya and seize Singapore, the strategic pivot of British defenses in Asia. Not since Yorktown had Britain suffered such a crushing setback. The world’s leading naval power had been bested by a challenger that exploited innovations in technology and doctrine to gain a marked qualitative edge in fighting power.

As far back as the 1920s, British decision makers and naval planners had foreseen the dangers posed by an expansionist Japan to Britain’s strategic position in Asia. British analysts and commentators took note of Japan’s industrial development, with exports employing a growing number of workers. Since the home islands were poor in natural resources, Japan’s industrial growth generated an increasing demand for imports of raw ma-

terials. British naval planners feared that this increased demand would, in turn, lead Japan to seek direct control over sources of supply by expansion in Asia.² The British Admiralty maintained that “the need of outlets for the population and for increased commerce and markets, especially new sources of self-supply, will probably be among the most compelling reasons for Japan to push a policy of penetration, expansion and aggression.”³

One astute British naval officer observed a struggle between a “section of the [Japanese] ruling classes” who favored cooperation with the West and the “military party, who have hitherto dominated Japan’s policy, [and] do not take kindly to these new ideas which, as a very minimum, presuppose the subordination of armies and navies to civilian direction.” Britain feared that a group of militarists, intent on exploiting nationalist sentiments, could emerge the winners in Japan’s internal power struggle. To prepare for this conflict, the Admiralty sought to recapitalize the naval force, and develop the logistical infrastructure to forward deploy a powerful fleet to the Pacific.

Plans to complete a strategic pivot to Asia as a hedge against an aggressive Japan confronted harsh economic realities in Britain, however. Britain suffered from sluggish economic performance throughout the interwar period: unemployment remained stubbornly high with older, staple industries no longer as competitive on world markets. In Asian markets, Japan posed a formida-

The fast attack submarine USS *Tucson* (SSN 770), the guided-missile cruisers USS *Lake Erie* (CG 70) and USS *Port Royal* (CG 73), the guided-missile destroyers USS *Chung-Hoon* (DDG 93), USS *Russell* (DDG 59), USS *Chafee* (DDG 90) and the Military Sealift Command fleet replenishment oiler USNS *Yukon* (T-AO 202) transit in waters surrounding the island of Oahu during the Koa Kai 11-2 naval exercise (MC2 Mark Logico, U.S. Navy).



ble trading competitor to Britain. With an overvalued currency, a heavy debt burden, and growing entitlement costs, Britain's international competitive position weakened. The press baron Lord Rothermere complained: "It really looks [as if] every economic thing in England is going wrong. We are ... quite unsuited to the era of intensive competition which is now setting in."⁴

Confronted by straitened economic circumstances, Britain's political leaders opted to run risks in the strategic arena rather than rearm and jeopardize the economy's prospects. Successive British governments during the 1920s and early 1930s curtailed the spending requests put forward by the Royal Navy for warship construction, operational readiness, and base development to protect Britain's interests in Asia. In naval aviation, a key element in determining command at sea, Britain was also falling behind its rivals Japan and the United States. As a consequence, by the 1920s Britain had become a "frugal superpower" and could ill afford an arms race against a rising great power competitor.⁵

Could a reversal of fortune of this magnitude—the world's leading naval power being soundly defeated by a rising challenger—happen again? The sad answer, of course, is that it most certainly could. Britain's strategic predicament—as "the embattled superpower"—offers insight into the strategic challenges that currently face the United States. The end of Britain's standing as a superpower conjures up a frightening scenario of how a post-American world might come about: not through a gradual, managed, "elegant decline," but through sudden defeat at sea.⁶

What might Americans of today learn from studying the collapse of an earlier superpower? Let me put forward just two sobering thoughts.

US President Barack Obama during a bilateral meeting with Chinese President Xi Jinping at the US Ambassador's Residence in Amsterdam, Netherlands, Monday, March 24, 2014. Obama was in the Netherlands for the Nuclear Security Summit in The Hague, which formed the backdrop for an emergency meeting of Group of Seven leaders on Russia's annexation of Crimea (Pablo Martinez Monsivais, AP Photo).



First, the United States must reverse its policy course and increase its defense budget. Current trends provide cause for worry, and unless the U.S. Navy can find a way to produce more force for less money, its capability to meet new threats in the Pacific will decline. The Obama administration's budget propos-

“For American leaders and academics to think they can “manage” China’s aspirations and actions might well be the great illusion of the twenty-first century.”

als would see defense spending drop to three percent of gross domestic product (GDP) by 2016. That measure of defense effort would continue to decline and is projected to drop to 2.3 percent of GDP by 2023.⁷ Britain's melancholy example underscores for American decision-makers that large defense cuts may undermine the stability of the regional order if a challenger is ready to take advantage.

Of particular concern, China's rising military effort calls into question the strategic wisdom of further cuts to spending. Defense reductions by the United States—when coupled with China's growing capabilities—portend a rapid and unwelcome shift in the international strategic landscape. To guide renewed defense efforts, Americans must first forge a consensus on an overall grand strategy. The United States needs to recapitalize its forces by undertaking programs for nuclear modernization, and to stay ahead of challengers in the aerospace, cyber, and maritime commons.

Second, a policy of seeking to accommodate the ambitions of rising challengers is fraught with difficulties and dangers. Britain faced four serious great power challengers in the early twentieth century: Germany, Japan, Russia (Czarist and Soviet), and the United States. Britain's attempts to appease these rising powers proved unsuccessful. The result was war, and the British world order being supplanted by one put in place by the strongest challenger, the United States. Despite the economic benefits these challengers enjoyed under the existing international order, their leaders were dissatisfied with Britain's leadership of that system. And, with increasing wealth at their disposal, the authoritarian rulers of Germany, Japan, and Russia armed their nations and adopted offensive strategies to pursue dreams of conquest.

American decision makers need to take seriously the demands of challengers that seek to change the existing global order through arms buildups and assertive behavior. Henry Kissinger, for one, hopes that the leaders of China and the United States can forestall a contest for mastery in Asia by sustained diplomatic engagement. Still, he fears how events might unfold if the "triumphalists"—ardent nationalists within China who seek to



The aircraft carrier USS Ronald Reagan (CVN 76) is underway on March 18, 2011 off the coast of Japan conducting humanitarian assistance missions supporting Operation Tomodachi (Naval Air Crewman 1st Class Jay Okonek, U.S. Navy).

reassert their country's former position as the dominant power in Asia—gain the upper hand in Beijing. As Kissinger warns, resurgent nationalism in China would likely prompt a containment strategy from the United States in response, but “[s]ooner or later, one side or the other would miscalculate.”⁸ Whether the United States can decisively influence the deliberations among China's rulers, policy advisors, and defense planners to encourage restraint in their foreign policy objectives, remains to be seen. For American leaders and academics to think they can “manage” China's aspirations and actions might well be the great illusion of the twenty-first century.

**The views expressed in this article are the author's alone.*

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Privateers!

Their History and Future

BY **Alexander Tabarrok** / **Alex Nowrasteh**



The schooner Lynx, a modern interpretation of a ship which was built for privateering in the War of 1812 sails into Morro Bay, California. It is used as an educational tool to teach people about the War of 1812 (Chuck Abbe).

Introduction

Government employment of private military firms is not a new phenomenon. During the Age of Sail, naval powers issued privateering licenses to shipowners, allowing and encouraging them to raid enemy commerce and attack foreign navies during times of war – a system that bears several similarities to modern military contracting. But private enterprise did not go to war in a legal vacuum. Privateering licenses were tightly regulated and their holders overseen by courts, which coexisted with other institutions that channeled private resources into war efforts at low cost to the state. Drawing on the American experience, we discuss the legal and economic structures of privateering, evaluate its effectiveness, explain its fall into disuse, and then discuss

the recent return of private military forces and the prospects for reviving institutions similar to those that regulated privateering.¹

Historical and Legal Foundations

Privateering was governed by a substantial system of legislation enforced through admiralty courts, prize courts, and bonds. In the United States, this system is founded on Article 1, Section 8 of the U.S. Constitution which gives Congress the power to “grant letters of marque and reprisal,” a power closely related to

Congress' preceding power: "to declare war." Letters of marque and reprisal, granted since the twelfth century, were designed to transform the anarchy of retaliation into lawful methods of seeking restitution. Sovereigns issued letters of marque and reprisal to raid enemy ships during wartime or periods of heightened international tensions. These special mechanisms allowed private means to be dedicated to public wars. Privateering played a critical role in the American Revolution, with around 700 licensed privateers active, compared to only about 100 ships in the official U.S. Navy.² The apogee of American privateering, however, was the War of 1812. On June 18, 1812, Congress declared war on Great Britain and began to issue letters of marque and reprisal.³ On June 26, 1812, Congress followed its declaration of war with greater detail on how privateers would be regulated.⁴ In this, Congress and the president who subsequently added to the regulations drew upon hundreds of years of legal traditions, practices, and regulations.⁵

The private market's response was swift. For example, the privateer *Comet*, owned by a group of wealthy Baltimore investors who anticipated the war, was commissioned on June 29, just 11 days after the declaration of war. On July 12, the *Comet* cleared Baltimore's harbor along with several other privateers, capturing its first prize on July 26, the 400-ton *Henry*.⁶ In less than 30 days a fleet of cruisers was launched from the coast of America ready to harass and imperil the British commercial fleet throughout the world.⁷ The privateers' entrepreneurial foresight and readiness stands in sharp contrast to that of the U.S. Navy, which had only eight seaworthy ships when the war began.⁸

Legal Institutions and Performance Bonds

In the era of the *Comet*, acquiring a privateer's license, called a commission, was the first step required by law in outfitting a privateer. Without a commission and oversight by a court, the privateer could not sell its prizes. A privateer's license was recognized as valid by courts throughout the world. Unlike pirates, who were punished as criminals outside the rule of law, privateers lawfully interfered with enemy shipping and were treated as opposing military forces under the law of nations. If a British warship captured an American privateer, for example, its captain and crew would be accorded the same rights as captured officers and crew of the U.S. Navy.

When a privateer captured a valuable prize, it was manned with a prize master and crew and instructed to set sail for the nearest friendly port. From the moment a prize arrived, its new owners were subject to rules regulating how they profited from the ship and its holdings. The cargo and ship could not be legally disturbed (no "breaking bulk") until the privateer had proven in a court of law that the vessel was owned by the enemy. To thus "condemn" a vessel, the privateer relied on the captured ship's papers, and the court would question the prize's captured officers, crew, and passengers. If the prize was found to be lawful, it was sold in a court-ordered auction. Congress stipulated, however, that if a court found a capture to have been made without just cause or otherwise unreasonably, it could order the owners

of the privateer to pay restitution to those harmed by the unlawful capture.⁹

The courts were judicious toward enemy vessels and their owners. A court declared the first two American prizes in the War of 1812 to be invalid because their skippers had not yet had the chance to learn of the state of war.¹⁰ American courts, operating under U.S. law, were even established in foreign countries to adjudicate prize cases brought by privateers who took their prizes to foreign ports. Benjamin Franklin sat as a judge in one such court in Paris during the American Revolution.¹¹

Congress also required that privateers respect the persons, property, and ships of neutral nations and legislated to incentivize the proper treatment of neutrals.¹² Privateers with crews of fewer than 150 men were required to pay a performance bond—a financial instrument whereby the purchaser forfeits the value if he violates the rules of the agreement—of USD 5,000. Ships with a larger crew paid USD 10,000. Each bond had to have at least two responsible sureties who did not have a financial stake in the privateer.¹³ The performance bond ensured that privateers would follow the rules laid down by Congress and the law of nations or face a large financial penalty—the value of the bond. In addition, the privateering ship itself was a form of collateral that could be sold by the courts to pay an adverse judgment. A typical privateer outfitted for around USD 25,000, not including wage advances to the crew, and the potential loss of that investment was a real deterrent against unlawful behavior.¹⁴

Ransoms

Capture followed by auction was not the only option available to the privateer. If the crew was short and the prize was far from a friendly port, the privateer could ransom the captured ship back to its captain, who would agree on behalf of the prize's owners to pay the ransom at a later date. The privateer would then release the prize and crew with papers that guaranteed the prize's safety if intercepted by another American privateer. Captain Boyle of the *Comet*, for example, chose this option at least four times during the War of 1812, agreeing to a USD 5,000 ransom in each case.¹⁵

The ransom took the form of a bond—a promise from the owners of the ship to the privateer, with the captain of the merchant ship as the surety.¹⁶ By themselves, promises seldom create expectations solid enough to support a well-established business practice such as ransom. There existed three legal constructs that helped a privateer recover a ransom in the event that the owners refused to pay.

First, ransoms were contracts enforceable in courts. While under British common law a promise made under duress was not enforceable, the threat under which ransom bonds were agreed was not personal but against the cargo and ship which the privateer had the legal right to sink.¹⁷ The privateer did not have standing to sue a British owner of a merchant vessel in Britain's courts. However, the captain of the captured vessel, who was

the surety for the ransom, could be sued and could in turn sue the owner in British courts. If the surety's suit was successful, he would then use the judgment to compensate the American owners of the ransom bond.

Second, the merchant's assets outside of the enemy nation could be legally seized through a process called repossession. When a merchant's vessels entered American or foreign ports, agents of the privateer could initiate legal action to seize them. After the British parliament made ransom promises unenforceable in 1782, thereby nullifying their status under common law, British merchants continued to pay ransoms because such promises were enforceable in the courts of other nations. During the War of 1812, the British government largely turned a blind eye toward these payments.

Third, the privateer often took a hostage, usually the captain of the ship or another officer, who would be released only after the ransom was paid. The hostage, in some instances, also served as the surety for the ransom bond and could be released to initiate legal action against the merchant ship's owners. Because the hostage was the surety, he owed the privateer for the value of the ransom if the owners did not pay, thus aligning the incentives of the privateer and hostage to seek redress in the courts. Privateers and merchantmen negotiated the terms under which such hostages were kept, extending even to how they would be cared for.¹⁸

For privateers, the reliability of ransom as a business option reduced the relative attractions of violence, mitigating the loss of life and the destruction of property. Those same benefits also accrued to enemy merchants, who easily preferred ransom costs to the destruction of property. This logic is straightforward: it is better to be taxed than to lose all of one's property. Ransom also benefited the government commissioning the privateers, as the option allowed its mobile and adaptive fleet to stay at sea for longer periods and harass ships closer to enemy shores. From the perspective of the state there were disadvantages to the practice of ransom, however, the most significant being that enemy ships and personnel were not removed from the war effort, but merely taxed.

Parole

This downside was equally evident in the legally defined practice of parole, which was also available to privateers. When a privateer captured a vessel of too low a commercial value to be worth sending back to port as a prize, the privateer could let the crew of the captured ship go free along with prisoners from previous prizes. Such freedom, granted with restrictions on the behavior of the released prisoners, was called a parole.

The advantages of parole were many. It was expensive for a privateer to feed and guard large numbers of prisoners, which was required by the law regulating privateers.¹⁹ The privateer's ability to take future prizes and the duration of its cruise were reduced by the presence of prisoners. For enemy merchants, parole de-

creased the costs of being captured but still imposed a significant burden. States, however, had to balance the greater freedom afforded its privateers versus the fact that parole did not decrease the supply of sailors available to the enemy.

Privateering Firms: Incentives and Organizations

A privateering firm earned revenues from ransoms and the sale of prizes. Merchant ships converted to privateers typically paid their crewmen fixed wages, as typical merchant sailors were paid, but they also earned shares of any prizes they captured. Crewmen on private men-of-war were paid exclusively in shares and therefore only earned their keep if they successfully captured prizes. Sailors in the Royal Navy and the U.S. Navy were not as well-incentivized.

Typically the owners of the privateering venture would keep half the shares, and the captain and crew would receive the other half (excluding shares devoted to repairs and maintenance and reserved for the captain to award crewmembers for especially meritorious conduct). The Articles of Agreement for the privateer *Comet* were typical. When in 1812 the *Comet* captured a British prize, the *Hopewell*, for example, Captain Boyle and his crew owned 256.75 shares in total (plus 13.25 shares at the Captain's disposal for rewards.) Boyle himself owned sixteen shares, the 1st lieutenant nine, the Captain of Marines six, each able-bodied seaman two and so forth down to the greenhands who owned one share each.²⁰ The captain kept shares in reserve to be awarded as bonuses; the first sailor to spot a prize and the first to board a fighting prize, for example, received bonus shares. Injured crewmen would also receive insurance payments, and in the event of death, a crewman's shares were bequeathable to his heirs.²¹ Each crew member's compensation was tied to the privateer's financial success.

Taxes, duties, and payments to auctioneers typically absorbed half the value of a prize, but the crew of a privateer lucky enough to bring in prizes could still profit handsomely. The *Hopewell's* capture paid an able-bodied crewman USD 210.78, or about seven months' worth of salary in alternative employment, while Captain Boyle's sixteen shares were worth USD 1,686.24, or about USD 327,000 today.²² Of course, not all voyages were successful. While privateering was a high-risk, high-reward profession for crew members, a privateering venture's financial backers could obtain consistent returns. The owners of the *Comet* received an estimated USD 220,000, or at least USD 42,600,000 in today's dollars, from the prizes, ransoms, and cargoes she captured during the War of 1812.²³

Evaluation and Decline

Privateers were a cost-effective and successful method of waging economic warfare through the War of 1812. Despite these successes, privateering declined after the war and was banned almost everywhere with the Declaration of Paris in 1856. Why did such a successful and low-cost way of fighting a naval war

decline?

The state's embrace of privateering was a response to its own fiscal limitations. Public navies were expensive, especially as they had to be maintained in times of peace as well as in times of war, and until the late nineteenth century tax systems tended to be ineffectual and inefficient. The funding base of the pre-Napoleonic Royal Navy, the era's preeminent naval force, is illustrative.

The first source of funding for Britain's navy was a variety of taxes earmarked for certain agencies and collected directly by them. Since 1347, the tonnage and poundage—a customs duty levied on merchant vessels docking in British ports—had been collected by the Royal Navy directly to compensate it for convoy protection duties.²⁴ If merchants could not trade in British ports, the Royal Navy would be stripped of this important source of revenue; this gave the Royal Navy an incentive to protect convoys and keep British ports open to trade.

The second and largest source of funds for the Royal Navy was debt. It issued bills of credit called Navy Bills when cash from other sources was unavailable. Navy Bills were a recognized short-term investment that bore interest after six months.²⁵ Customs duties collected by the Royal Navy serviced these debt obligations. Bondholders followed Navy actions with attentiveness to verify that the force efficiently administered and properly prioritized convoy protection to guarantee the continual flow of customs duties.²⁶ Although it was technically illegal for the Royal Navy to issue bonds, Parliament tacitly approved of the system because it did not want to fund the entire Navy budget. The Treasurer of the Navy was the only public accountant who did not have to produce vouchers or open his books to Parlia-

ment.²⁷ As maintaining its credit rating was vital for the Navy to sell bonds in the future, the fleet's size tended to expand during war as the Navy stretched itself to protect trade and customs duties.

A third source of funding was tax revenue appropriated by Parliament. While Parliament frequently granted monies, paid off Navy Bills, or assumed debts, large portions of Navy expenditures were in practice self-financed. As a consequence, Parliament never completely controlled naval spending.

In the face of fiscal inefficiencies similar to those that plagued Britain, governments everywhere relied on and welcomed the low-cost transformation of merchant vessels into raiders. The privateering system meant that there was always a ready stock of war-fighting ships available that did not require maintenance by the state.

In the United States, opposition to standing armies and navies also motivated the use of privateers. The founders feared standing armies as a threat to liberty. At the constitutional convention, for example, James Madison argued that "A standing military force, with an overgrown Executive will not long be safe companions to liberty. The means of defence against foreign danger have been always the instruments of tyranny at home."²⁸ For the founders, the defense of the country was best left to citizens who would take up arms in times of national peril, form militias, overcome the peril, and then to return to their lives.²⁹ Explaining why the United States would not sign the 1856 Treaty of Paris, William Marcy, Secretary of State, said:

The United States consider powerful navies and large standing armies as permanent establishments to be detrimental to national

The schooner *Pride of Baltimore II* sails near Baltimore Harbor with the schooner *Alcyone* alongside (Bill McAllen).



*prosperity and dangerous to civil liberty. The expense of keeping them up is burdensome to the people; they are in some degree a menace to peace among nations. A large force ever ready to be devoted to the purposes of war is a temptation to rush into it. The policy of the United States has ever been, and never more than now, adverse to such establishments, and they can never be brought to acquiesce in any change in International Law which may render it necessary for them to maintain a powerful navy or large standing army in time of peace.*³⁰

The growing power of the state to collect tax revenue and afford a permanent, large navy in Europe and the United States meant that the cost-saving advantages of privateering became relatively less attractive. Improvements in technology also made privateering less effective. A few extra cannon and men could convert a merchant vessel into a commissioned vessel capable of capturing small prizes, should any cross her trading route. But as military technology developed, substitution between private and military use became more difficult. It was one thing to transform an eighteenth century merchant vessel into a privateer and quite another to build an attack submarine with private capital. The ideological commitment in the United States against standing armies and militarism also faded away.

Additionally, privateering had always been an imperfect system from the state's point of view. The misalignment of state and privateer incentives created tensions which threatened the potential for privateering to advance national interests. Ransoming and parole benefited privateers and their captures, but it was not always in the interests of their respective governments. A ransomed ship could carry cargo another day and paroled prisoners and prisoner exchanges could release manpower to the enemy. When governments could maintain their own navies, they decided to remove the legal bases for those activities.

The first steps toward outlawing privateering came in the form of assaults on the legal underpinnings of the practice of ransoming and parole. The British government outlawed ransoming as early as 1782, for example, and was followed by the Americans in 1813.³¹ The British also began to deny the legitimacy of parole by the end of the War of 1812. The U.S. Congress made parole a comparatively less attractive option by raising the bounty on captured enemy prisoners from USD 20 in 1812 to USD 25 in 1813 and USD 100 in 1814.³² In March 1813, Congress also offered a substitute for ransom: the U.S. government would pay to any privateer who would "burn, sink or destroy" any armed British vessel half the value of that vessel.³³ In this way, privateers became more and more like government contractors and were redirected toward the goal of committing maximum destruction against the enemy. Eventually, states decided to move away from managing complicated incentives and toward direct command of their own naval power.

The state's increasing ability to directly fund and staff navies also created conflicts with privateering ventures as the two competed to hire experienced sailors.³⁴ British privateers offered higher wages and better working conditions than the Royal Navy, and

drew many of the best trained and most experienced seamen toward privateering. In some instances, armed fights broke out between Royal Navy personnel and privateers competing for sailors.³⁵ This competition produced large and endemic personnel shortages for the Royal Navy. As a result of this shortage, the Royal Navy relied on impressments, or the kidnapping of experienced sailors and sometimes landsmen, to man its ships. However, because the law exempted privateering crews from impressment, this tactic exacerbated the Navy's manpower shortage by incentivizing experienced sailors to join privateering crews for a lower wage.³⁶ Once implemented, the outlawing of privateering relieved the manpower shortage.

Present Status

The practice of contracting out government functions, such as the manufacturing of uniforms and military equipment, to private firms never disappeared completely and has grown in recent years. For most of the fiscal quarters between 2007 and 2013 in Afghanistan and most quarters from 2008 to 2011 in Iraq, for example, the number of private contractors exceeded the Department of Defense (DOD) workforce.³⁷ Many contractors are locals who offer noncombat services, including logistical support for U.S. troops. However, significant numbers have also been involved in security operations. In March 2013, for example, there were 108,000 DOD contractors in Afghanistan, of which 18,000 were private security contractors, which compares with 65,700 U.S. troops in the country that month.³⁸

The modern U.S. government has used contractors for many of the same reasons privateers were advantageous in the Revolutionary era. Contractors do not need to be hired on permanently and can quickly be called up to meet a crisis or drawn down after the crisis dissipates. Contractors often have specific expertise—language skills or country knowledge today—which are more expensive for the government to maintain on a permanent basis. Additionally, contractors are also more incentive-driven than government bureaucracies, making them relatively nimble and willing to innovate.³⁹

To be sure, the use of private contractors has created many of the same tensions as the use of privateers in earlier wars.⁴⁰ Private military contractors (PMCs) and the military, for example, compete for soldiers, especially elite soldiers.⁴¹ In 2005, the Pentagon began offering reenlistment bonuses of up to USD 150,000 for special forces personnel.⁴² However, the competition for elite personnel is not always zero-sum. Doug Brooks, president of the International Peace Operations Association, observes that the temporary nature of security contracting appeals mainly to special forces soldiers who were otherwise intending to retire—meaning that private contracting could actually increase the supply of soldiers available on the battlefield.

There are other reasons why manpower competition is less of an issue for the U.S. DOD than it was for the Royal Navy. As foreigners are rarely allowed to serve in the U.S. military (the

only noncitizens who can enlist, with few exceptions, are lawful permanent residents), but can be hired by private firms, contracting may expand the size of the potential manpower pool. While foreign governments could also hire former U.S. soldiers, thereby offsetting the manpower benefit, in practice the U.S. government remains the largest purchaser of specialized military personnel. Another potentially supply-increasing effect is that more soldiers may decide to join elite military forces because they will be eligible for lucrative employment as a contractor after they are discharged.⁴³ More generally, one of the main justifications for hiring contractors to support the troops is that it frees up military personnel for combat units.⁴⁴

While the contracting of private firms has benefited the U.S. DOD, some problems have emerged due to their profit-driven structure. The difficulty of writing and monitoring complex contracts means that contractor and government incentives are never perfectly aligned. Privateers in 1813 wanted to capture ships, not sink them (until the U.S. government paid them directly for sinking). Similarly, contractors in Afghanistan were paid to protect convoys of U.S. materiel but may have done so in a way that compromised larger goals.

On the positive side, a U.S. House of Representatives oversight committee reported that the private system worked well in delivering goods:

*[T]he Host National Trucking [HNT] providers supply almost all U.S. forward operating bases and combat outposts across a difficult and hostile terrain while only rarely needing the assistance of U.S. troops. Nearly all of the risk on the supply chain is borne by contractors, their local Afghan truck drivers, and the private security companies that defend them. During the Soviet Union's occupation of Afghanistan (1979–1989), by contrast, its army devoted a substantial portion of its total force structure to defending its supply chain. The HNT contract allows the United States to dedicate a greater proportion of its troops to other counterinsurgency priorities instead of logistics.*⁴⁵

However, delivering supplies was a means to an end and not an end itself. Many of the contractors, local Afghans employed by the firm, were paying insurgents not to attack the convoys. The payments were effective in accomplishing the contractor's goal—getting the goods delivered—but to the extent that the payments ultimately supported the insurgency they were at cross-purposes with the U.S. mission.⁴⁶

A more general problem is that writing and managing contracts is difficult. Profit-driven systems incentivize private firms to act quickly, lower costs, and innovate, but also to game the system and exploit the buyer. Contracting problems are especially acute when quality is important but difficult to measure. It is relatively easy to judge the quality of goods, for example, but much harder to judge the quality of services like security.

Although contractors are now an indispensable part of any U.S. military operation,⁴⁷ the job of writing and managing contracts

is not valued within the military as a key aspect of warfighting. Thus, the Commission on Wartime Contracting argues that contingency contracting should be raised to the level of other Joint Staff functions like intelligence, plans, and operations.⁴⁸ In addition, to avoid problems of waste, fraud and, abuse, there must be greater training in the theory and practice of incentive design.⁴⁹

Adopting novel contract forms and provisions could better align PMC and government interests. U.S. privateers, for example, were required to purchase performance bonds which could be forfeited in light of bad behavior. Currently, the U.S. military does not require PMCs to purchase bonds, but their use should be evaluated as a way to structure incentives correctly. The French government considered requiring military suppliers to sign performance bonds but the measure was not adopted.⁵⁰

“While the contracting of private firms has benefited the U.S. DOD, some problems have emerged due to their profit-driven structure.”

In addition to designing better contracts, the government also needs to monitor PMCs more closely. As the dollar value of contracts skyrocketed in Iraq and Afghanistan, the DOD staff responsible for monitoring PMCs shrank by 25 percent.⁵¹ In 2010, each government auditor was responsible for over USD 2 billion of private military contracts.⁵²

Finally, and more radically, bounties, another vestige of the privateering system, could also be increased and made available more frequently. The U.S. Department of State's Rewards for Justice program has since 1984 provided USD 125 million to informers around the world who have helped to bring terrorists like Ramzi Yousef, the plotter behind the 1993 World Trade Center attack, Abu Solaiman, Hamsiraji Marusi Sali, and others to justice.⁵³ The program was expanded in 2013 to allow payments leading to the arrest of individuals wanted by the International Criminal Court.

Within the U.S. criminal justice system, bounties are routinely used not only to incentivize informants, but also to encourage the capture and apprehension of bail jumpers. The incentive approach works: bounty hunters are much more likely to recapture felony defendants who jump bail than police are to re-arrest similar defendants who fail to appear.⁵⁴ If rewards on terrorists such as Ayman al-Zawahiri, currently the United States' most wanted, were raised from USD 25 million to USD 250 or USD 500 million, the government would incentivize not only information provision but also active pursuit—a return of true privateering. In conjunction, an international bounty hunter license for war criminals or human rights abusers could be authorized by the United Nations Security Council under its powers to

combat threats to international peace and security.⁵⁵ Such an authorization could create obligations for states to erect a legal framework to support or tolerate the bounty-hunters' activities.⁵⁶ The private pursuit of justice would no doubt be controversial and problematic, but so too have been the wars in Afghanistan and Iraq undertaken to combat terrorism.

Conclusion

For hundreds of years, governments drew on privateers for their initiative and industry. The incentives of privateers and the governments that commissioned them were always imperfectly aligned, but when governments were unwilling or unable to maintain permanent navies the benefits outweighed the costs. As governments became more powerful, the privateering system declined, but rather than being eliminated, it evolved into the contracting out of services. The acceleration of this process today reflects current budgetary pressures and the need for greater flexibility in the use and deployment of military assets to face asymmetric threats.

The problem of aligning the incentives of private firms with national policy was a concern during the era of privateers and remains one today. Government regulation, oversight, and development of well-designed contracts that incentivize private military firms and contractors to act in the interests of national policy are all essential. The institutions that regulated privateers were surprisingly well-honed for the task, and helped to mitigate governments' resource constraints during the Age of Sail. Careful contract design based on the lessons learned from privateering regulations can re-harness private initiative to serve today's national interests.

1. We draw upon Alexander Tabarrok, "The Rise, Fall, and Rise Again of Privateers," *The Independent Review*, Vol. 11, No. 4 (Spring 2007), 565–577.
2. Reuben E. Stivers, *Privateers and Volunteers: The Men and Women of Our Reserve Naval Forces, 1766 to 1866* (Annapolis: Naval Institute Press, 1975); U.S. Maritime Service Veterans, "Privateers and Mariners in the Revolutionary War," website, May 29, 2012, available from <http://www.usmm.org/revolution.html> last accessed January 23, 2015.
3. 'An Act Declaring War Between the United Kingdom of Great Britain and Ireland and the Dependencies Thereof, and the United States of America and Their Territories', Annals of Congress, 12th Congress, 1st Session, 2323–2324, available from <http://memory.loc.gov/ammem/amlaw/lwac.html>.
4. 'An Act Concerning Letters-of-Marque, Prizes and Prize Goods', Annals of Congress, 12th Congress, 1st Session, 2327–2328.
5. See Hugo Grotius, *Commentary on the Law of Prize and Booty* (Indianapolis: Liberty Fund, 2012). Available from Project MUSE, <http://muse.jhu.edu> last accessed October 20 2014.
6. Jerome R. Garitee, *The Republic's Private Navy* (Middletown: Wesleyan University Press, 1977), 150.
7. Garitee notes that "The instructions given Captain Henry Dashiell of the privateer Saranac in January of 1815 reflected experiences gained in two and half years of war....they instructed Dashiell to cruise for ten days

- east of Bermuda and then to head for Barbados for a twenty-day cruise. If he still had sufficient officers and men to man prizes, he was then to steer for Madeira. After Madeira, off the African coast, the captain was to use his discretion, but he was encouraged to cruise in and off the English and Irish channels." See Garitee, *The Republic's Private Navy*, 144.
8. Donald B. Chidsey, *The American Privateers* (New York: Dodd, Mead & Company, 1962), 89.
 9. 'An Act Concerning Letters-of-Marque, Prizes and Prize Goods', Annals of Congress, 12th Congress, 1st Session, 2327–2328.
 10. Chidsey, *The American Privateers*, 88. For other examples of the courts invalidating prizes and enforcing payment of damages, see Garitee, *The Republic's Private Navy*, 156, and Donald A. Petrie, *The Prize Game* (Annapolis: Naval Academy Press, 1999), 160.
 11. Petrie, *The Prize Game*, 155
 12. Garitee, *The Republic's Private Navy*, 97–98, "An Act Concerning Letters-of-Marque, Prizes, and Prize goods," 2327–2328.
 13. 'An Act Concerning Letters-of-Marque, Prizes, and Prize goods', 2327–328.
 14. The cost of a privateer is from Garitee, *The Republic's Private Navy*, 111, 125. USD 25,000 in today's dollars using the CPI is USD 452,000 or USD 4,840,000 using the wages of unskilled labor as a comparison. See Tabarrok, 'The Rise, Fall, and Rise Again of Privateers'.
 15. Garitee, *The Republic's Private Navy*, 272.
 16. Henry Wheaton, *A Digest of the Law of Maritime Captures and Prizes* (New York: Forbes & Co, 1815), 236.
 17. Petrie, *The Prize Game*, 20.
 18. Peter T. Leeson and Alex Nowrasteh, "Was Privateering Plunder Efficient?," *Journal of Economic Behavior and Organization*, Vol. 79, No. 3 (August 2011), 312–313.
 19. Garitee, *The Republic's Private Navy*, 97–98.
 20. Garitee, *The Republic's Private Navy*, 192.
 21. See, for example, the Articles of Agreement of the privateer *Yankee* in Chidsey, *The American Privateers*, 104.
 22. Garitee, *The Republic's Private Navy*, 191. We use the "labor value of the commodity" from <http://www.measuringworth.com/uscompare/relativevalue.php>
 23. Garitee, *The Republic's Private Navy*, 272.
 24. Nicholas A. Rodger, *The Command of the Ocean: A Naval History of Britain, 1649–1815* (New York: W.W. Norton & Company, 2004), 160.
 25. Rodger, *The Command of the Ocean*, 293.
 26. Rodger, *The Command of the Ocean*, 293.
 27. Rodger, *The Command of the Ocean*, 370.
 28. Quoted in Max Farrand's Records of the Federal Convention of 1787, Vol. I [1] (1911), 465, available from <http://memory.loc.gov/ammem/amlaw/lwfr.html> last accessed January 23, 2015.
 29. John P. Reid, *In Defiance of the Law: The Standing-Army Controversy, The Two Constitutions, and the Coming of the American Revolution* (Chapel Hill: University of North Carolina Press, 1981); Leon Friedman, 'Conscription and the Constitution: The Original Understanding', *Michigan Law Review*, Vol. 67, No. 8 (June 1969), 1493–1552; Arthur Ekirch, Jr., *The Civilian and the Military: A History of the American Anti-Militarist Tradition* (Oakland: Independent Institute, 2010 2nd Ed.).
 30. Quoted in Henry Maine, *International Law: A Series of Lectures Delivered Before the University of Cambridge, 1887* (London: John Murray, 1915 2nd Ed.). Available online at Avalon Project: http://avalon.law.yale.edu/subject_menus/intmenu.asp last accessed January 23,

2015.

31. Garitee, *The Republic's Private Navy*, 168.

32. Garitee, *The Republic's Private Navy*, 168.

33. Chidsey says the armed qualification was not so important since most ships were armed. Petrie argues that this only applied to official Navy war ships; see Petrie, *The Prize Game*, 45-46.

34. The Royal Navy and privateers also competed for all forms of ships, naval stores, and armaments. Often the Royal Navy ended up with inferior goods because it refused to pay higher prices. Sir Wager remarked to Admiral Vernon at the start of the War of the Austrian Succession, "We must do as well as we can, but we find great Difficulty in getting Seamen enough for our ships, which has been our Case in all our considerable Sea Armaments"; see Edward Vernon, *Original Letters to an honest Sailor* (London: 1746), 4. Privateers consumed substantial quantities of war material. One hundred and twenty privateers docked in Liverpool in 1779 had an aggregate tonnage of 31,385 and carried 1,986 guns; see Gomer Williams, *History of the Liverpool Privateers and Letters of Marque with An Account of the Liverpool Slave Trade, 1744-1812* (Montreal: McGill-Queen's University Press, 2004), 20. Privateers demanded speedy ships that were also in demand by the Royal Navy. Brigs, schooners, slavers, and sloops were all used in various capacities in the Royal Navy. During the Napoleonic Wars, never less than a quarter of Royal Navy ships were prizes that it had captured; see Nicholas Rogers, *The Press Gang: Naval Impressment and Its Opponents in Georgian Britain* (London: Continuum Books, 2007) 483.

35. Rogers, *The Press Gang*, 82, 85.

36. Geoffrey J. Marcus, *A Naval History of England: The Formative Centuries* (Boston: Atlantic Monthly Press, 1961), 374.

37. Moshe Schwartz and Jennifer Church, "Department of Defense's Use of Contractors to Support Military Operations: Background, Analysis, and Issues for Congress," CRS Report for Congress R43074, May 17, 2013, Congressional Research Service, Washington, D.C., 24-25.

38. Schwartz and Church, "Department of Defense's Use of Contractors to Support Military Operations," 2.

39. Congressional Budget Office, "Logistics Support for Deployed Military Forces," CBO Study, October 2005, Congressional Budget Office, Washington, D.C. Blackwater founder Erik Prince's history of Blackwater is useful in recounting how the firm grew quickly by filling a demand for training, intelligence and security services that the police and the military could not supply in response to a series of crises--beginning with the Columbine High School shootings in 1999 and continuing with the attacks on 9/11. See Erik Prince, *Civilian Warriors: The Inside Story of Blackwater and the Unsung Heroes of the War on Terror* (New York: Portfolio Trade, 2014).

40. Peter W. Singer, 'Outsourcing War', *Foreign Affairs*, Vol. 84, No. 2 (March/April 2005), 119-133.

41. David Isenberg, *Shadow Force: Private Security Contractors in Iraq* (Westport: Praeger, 2009).

42. Extracts of interview with Doug Brooks at PBS, "Frontline: Private Warriors – Frequently Asked Questions," website, June 21, 2005, available from <http://www.pbs.org/wgbh/pages/frontline/shows/warriors/faqs/> last accessed January 23, 2015.

43. Suzanne Kelly, 'Confessions of a private security contractor', CNN Security Blog post, December 27, 2011, available from security.blogs.cnn.com/2011/12/27/confessions-of-a-private-security-contractor last accessed January 23, 2015.

44. Schwartz and Church, 'Department of Defense's Use of Contractors

to Support Military Operations', 3.

45. U.S. House Committee on Oversight and Government Reform, "Warlord, Inc.: extortion and corruption along the U.S. supply chain in Afghanistan," report by the majority staff of the Subcommittee on National Security and Foreign Affairs, June 2010, U.S. House of Representatives, Washington, DC.

46. U.S. House Committee, "Warlord, Inc."

47. Singer, "Outsourcing War."

48. Commission on Wartime Contracting, "Transforming Wartime Contracting: Controlling Costs, Reducing Risks," Final Report to Congress, August 2011, U.S. Congress, Washington, D.C.

49. Tyler Cowen and Alexander Tabarrok, "Managing Incentives," in Tyler Cowen and Alexander Tabarrok, *Modern Principles of Economics* (New York: Worth Publishers, forthcoming 2016), Chapter 22.

50. White Paper Commission, *The French White Paper on Defence and National Security* (New York: Odile Jacob, 2008), 267.

51. Peter W. Singer, "The Regulation of New Warfare," *The Politic*, February 27, 2010, available from <http://thepolitic.org/the-regulation-of-new-warfare-2/> last accessed January 23, 2015.

52. Singer, "The Regulation of New Warfare."

53. U.S. Department of State Bureau of Diplomatic Security, 'Rewards for Justice – Success Story', website, December 3, 2014, available from http://www.rewardsforjustice.net/english/hamsiraji_sali.html last accessed December 4, 2014.

54. Eric Helland and Alexander Tabarrok, "The Fugitive: Evidence on Public versus Private Law Enforcement from Bail Jumping," *Journal of Law and Economics*, Vol. 47, No. 1 (April 2004), 93-122; Alexander Tabarrok, "The Bounty Hunter's Pursuit of Justice," *The Wilson Quarterly*, Vol. 35, No. 1 (Winter 2011), 56-61.

55. Christopher M. Supernor, "International Bounty Hunters for War Criminals: Privatizing the Enforcement of Justice," *Air Force Law Review*, Vol. 50, (2001), 215-252.

56. Drawing on the precedent of UN Security Council resolutions 1373 (2001), 1540 (2004), and 2178 (2014), which obligated states to create or improve legal regimes for combatting terrorism, proliferation of weapons of mass destruction, and the movement of foreign fighters.

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Nip It in the Bud

Disrupting Insurgent Financial Networks Before They Take Hold

BY **Tom Keatinge**

The rapid rise of Islamic State¹ has galvanised the international community to take action to contain it. One issue in particular – financing – has drawn increasing attention from policy-makers. As U.S. Secretary of Defense Chuck Hagel noted in August 2014, “ISIL is as sophisticated and well-funded as any group that we have seen. They’re beyond just a terrorist group... they are tremendously well funded.”² He elaborated on this further in September testimony to the U.S. Senate Armed Services Committee, stating that the United States would work with international partners “to cut off ISIL’s funding” and that “the Department of Treasury’s Office of Terrorism and Financial Intelligence is working to disrupt ISIL’s financing and expose their activities.”³ This decision by international partners to jointly focus on finance disruption has resulted in a bombing campaign partly targeting oil refineries (a major source of funds for Islamic State) and in a UN Security Council Resolution that exhorts the international community to inhibit foreign terrorist fighter travel and otherwise disrupt financial support.⁴

But will it work? This article will give necessary broader context on this key question by exploring in more general terms the importance of financing for terrorist and insurgent groups and the extent to which disrupting their funding can reduce the security threat posed by such groups. Specifically considering the evolution of Islamic State, this article will first review the importance of financing in conflict, then assess the way in which funding models develop. It will argue that, once groups move from a reliance on externally sourced funding to generating sufficient internal financing – a path several groups have now followed – disruption becomes significantly more challenging and complex. The international community consistently fails to prioritise the early disruption of terrorist and insurgent financing – an attitude that needs to change.

The challenge of financing in conflict is as old as conflict itself. In his series of Philippic speeches, the Roman orator Marcus Tullius Cicero (106 BC – 43 BC) observed that “The sinews of war

Official IRA parade, Downpatrick, through town on Easter Sunday, 1974. The populist support for the IRA in parts of Ireland allowed it raise funds in support of its cause via both legitimate businesses and criminal activity (Burns Library Boston College)



[are] a limitless supply of money.”⁵ During the Cold War, states sponsored violent insurgents via funding and supporting proxies. For instance, the U.S. provided significant financial support to opponents of Chilean President Allende in the early 1970s and the Afghan Mujahedeen in the 1980s. The Soviet Union (primarily via satellite states such as Czechoslovakia, Cuba, and Bulgaria) supplied training and weapons to Western European Marxist groups such as the Red Brigades in Italy, as well as groups in Western colonial outposts such as Mozambique and Rhodesia/Zimbabwe.⁶

Whilst state sponsorship was important during this period of political proxy violence, terrorist groups also sourced funding from their diaspora, criminal activities, and both legal and black market businesses. For example, the Provisional IRA in Northern Ireland raised money via an empire of legitimate businesses such as mini-cabs, shops, construction firms, and pubs; criminal activity such as tax fraud, smuggling, and kidnapping; as well as from supporter organisations such as Irish Northern Aid Committee (NORAI) and FOSF (Friends of Sinn Féin), the Irish-American fundraising bodies.⁷ The end of the Cold War and the concerted use of UN Security Council Resolutions against countries such as Libya and Sudan⁸ saw a dramatic decline in state-sponsored terrorism, and whilst organisations such as Hezbollah continue to operate with state-backing, most of the terrorist organisations that have emerged since the Cold War, such as Al-Qaeda, have not been able to rely on state sponsorship, thus needing to source their own financing.⁹

“[A]s AQI has evolved over the past decade...to become the Islamic State, [it] develop[ed] a financial model that allows it to operate with significant financial independence.”

As Dennis M. Lormel, who at the time of 9/11 was the Chief of the FBI's Counter-Terrorist Financing Operations Section, has noted, “Funding is both the lifeblood of a terrorist organisation and one of its most significant vulnerabilities.”¹⁰ Securing and maintaining reliable funding is the key to moving from fringe radical group to recognised terrorist organisation, from a hand-to-mouth existence to a more planned and organised model.¹¹ As we are seeing in many current terrorist and insurgent theatres, in the light of waning state-sponsorship and strengthened Counter-Terrorist Finance (CTF) regulations, successful groups are often defined as much by their skills as financial managers as they are by their military expertise.

The importance of finance is also underlined by the actions of the international community as it attempts to systematically target the financial resources of those seeking to conduct terrorism.

September 11 jump-started the global use of Counter-Terrorist Finance in the form of Executive Order 13224 signed on 23 September 2001, which was the first step in President George W. Bush's so-called ‘War on Terror’. Announcing the signing of the EO, he defiantly announced, “Today, we have launched a strike on the financial foundation of the global terror network. . . We will starve the terrorists of funding. . .”¹²

Therefore as financing is so important to successfully sustaining an insurgent or terrorist campaign, it should be the case that disrupting funding and thereby cutting off the lifeblood of these organisations should lead to their demise. The answer, however, is inevitably more nuanced as is revealed by a review of the financing of opposition groups fighting the Assad regime in Syria. Two starkly different models exist, often dependent on the maturity of the group: those that rely on funds from international supporters and those that benefit from the war economies generated by their territorial expansion.

Many of the groups that took up arms in 2011 and 2012 relied almost entirely on donations received from supporters across the Gulf region. The provision of funds to these ‘start-up’ groups was in most cases initially motivated by a humanitarian imperative and a desire to relieve suffering.¹³ However, in actuality donor funds were often diverted and, knowingly or not, misused to eventually ‘super-empower’ more radical groups, which exacerbated sectarianism, and undermined much of the international community's effort to influence the conflict's outcome. As one analyst put it, donor funding has helped to create “a self-sustaining dynamic that is totally independent of all the strategic and diplomatic games that are happening and being led by states.”¹⁴

It is worth pausing for a moment to note that alongside the humanitarian imperative, the Qur'an has been interpreted by some as encouraging such private donations, emphasising the importance of giving generously to the cause of violent Jihad, thus linking voluntary, charitable contributions to a war effort.¹⁵ The most common method of contribution is ‘Tajheez Al-Ghazi,’ simply defined as fitting or arming a soldier. This allows those who cannot, or will not, join the Jihad physically for whatever reason to achieve the honour and heavenly reward of waging Jihad by financial proxy. Donations and sponsorship are encouraged, for “Whoever arms a Ghazi then he would be considered a Ghazi, and whoever looked after the family of an absent Ghazi, he will too be considered a Ghazi.”¹⁶

Today, this support takes the form of money, paid to individuals aspiring to make their way to jihadi theatres or raised to buy weapons for those already fighting. For example, the New York Times reported a campaign run by a Syria-based Saudi sheikh close to Al-Qaeda, called “Wage Jihad With Your Money” in which donors were told that they would earn “silver status” by giving US\$175 for fifty sniper bullets, or “gold status” by giving twice as much for eight mortar rounds.¹⁷ The concept of financial Jihad encourages rebel groups to emphasise their Islamic credentials, thus shaping these groups' strategies to maximise their appeal to those for whom the ideology of the recipient

is important and making private donors the power brokers between rebel groups.¹⁸

This externally-funded model has, however, proven to have some weaknesses. Al-Qaeda in Iraq (AQI), as it then was, learnt valuable lessons about financing in the period following the U.S.-led invasion of Iraq in 2003, at a time when it was funded primarily by donors. Amongst the documents discovered and declassified by the U.S. Department of Defense for review in the Harmony Database is a 'lessons learned' analysis believed to have been drawn up by an AQI commander in light of the destruction of the group at the hands of the Iraqi 'Sunni Awakening' and U.S. military support during 2006–2007. Included in the list of nine lessons, along with such reasons as failure to understand the Iraqi people, tensions between foreign fighters and AQI members, and suicide bombers reneging, is a reference to the "poor use of financial resources."¹⁹ In the view of this commander, AQI did not distribute funding effectively, paid out funding without properly analysing the proposed use and, critically, did not have regular funding sources.

Unfortunately, as AQI has evolved over the past decade through various incarnations to become Islamic State, the group appears to have learnt from its mistakes, developing a financial model that allows it to operate with significant financial independence. In contrast to the reliance placed on external financing by the new groups established since the start of the conflict, Islamic State now operates almost entirely from internally generated financial sources built up over recent years. It has garnered funds from territorial expansion and the war economy: control of key financial nodes such as arterial roads and commerce districts allows it to raise taxes from businesses and charge transportation tolls. For example, vehicles travelling along the busy highway from Baghdad to Jordan are charged US\$800, US\$20 is collected from businesses in Raqqa every two months for water, security, and electricity, and a 5% tax is collected for social welfare and other public purposes from all salaries.²⁰ Islamic State also controls oil fields in northern Syria and Iraq from which it is estimated to earn up to US\$1.6 million per day²¹ through smuggled trade with brokers in Turkey as well as trade with the Assad regime itself.

Although steps can be taken to cut off the limited amount of donor funding flowing to Islamic State, the ability of the international community to disrupt internally-generated funding is mixed. Whilst a report in November by the International Energy Agency indicates that "the coalition's targeting of ISIS-held oil infrastructure has knocked crude production down to around 20,000 barrels per day (bpd) from a high of about 70,000 bpd,"²² disrupting other sources of internal financing such as taxation and transport tolls is challenging. The ability of Islamic State to rely on these other income channels remains to be seen as the coalition aerial bombardment campaign continues.

Al-Shabaab in Somalia also offers an instructive case study in the success these groups can enjoy with internal funding models. The longevity and success of Al-Shabaab can be substantially

attributed to its impressive financial management, minimising its reliance on external sources of funding such as diaspora and donor financing whilst building a highly effective domestic funding system based on taxation and trade. Al-Shabaab has developed a highly diversified and innovative funding model²³ that relies on the "financial control and surveillance of cashflows,"²⁴ and involves sources that are, on the whole, internal to Somalia, not heavily reliant on third parties, and thus within the group's control. According to the UN in 2011, Al-Shabaab's annual revenue was in the region of US\$70–100 million per year stemming from "duties and fees levied at airports and seaports, taxes on goods and services, taxes in kind on domestic produce (such as charcoal), checkpoints and various forms of extortion justified in terms of religious obligations, or zakat."²⁵

And despite military pressure, the loss of key financing nodes such as Bakara Market in Mogadishu and the ports of Kismayo and Barawe, and calls by the UN for those that facilitate Al-Shabaab's trade (particularly the trade in charcoal) to desist, the group continues to control large swathes of territory. This allows it to earn revenue from the taxation of people, businesses, and transportation and offer a form of proto-government across much of South Central Somalia that contrasts favourably with the instability and corruption of the national government.²⁶

**“ [T]argeting financing is...
most effective when groups
are in their 'start-up' phase[.]”**

The relative stability terrorist groups achieve by establishing an internal funding model takes time. Thus, whilst targeting financing is clearly an important element of any counterterrorism strategy, this will be most effective when groups are in their 'start-up' phase, when disruption is easier given the reliance groups place on donors and other forms of external finance in their nascent form. As already noted, one of the main reasons AQI attributed to its failure was its lack of regular and reliable funding sources. And going further back, the history of Al-Qaeda itself might have been very different if it had not successfully attracted significant funding from its "golden chain" of donors.²⁷ Once groups move from a hand-to-mouth financial existence and build reliable and sustainable internal sources of revenue (as illustrated by the case of Al-Shabaab and Islamic State), disruption becomes much more challenging for the international community. Early action against financial sources is key before groups' self-sustainability is achieved.

In sum, building a resilient financing framework is demonstrably an existential factor for terrorist and insurgent groups and thus targeting their different financing channels can have a meaningful impact on their operations and survival. But the international community's ability to disrupt these groups in this manner is substantially hindered by two fundamental flaws. First, money flows like water and will exploit systemic weaknesses. The lack

of commitment by certain states to curtail terrorist financing flows severely undermines international efforts to disrupt funding – these states are “holes” through which money will leak to insurgents. Witness the extent to which funds in support of groups fighting in Syria, some of which are designated terrorist organisations, flowed from donors in Kuwait. Secondly, despite the global recognition that targeting financing is a strategically important element of the global counter-terrorism effort underpinned by the long menu of national and international laws and resolutions, the international community is consistently too slow to act. Whilst CTF regulations and global financial control systems exist in theory, the coordinated application of these tools is still far from reality. The result is that, as we now see in Syria and Iraq, by the time action is taken against a group’s finances, it has often moved from being vulnerable as a start-up to having the financial strength and resources of a mature and well-established organisation. By this point, a group’s destiny is more likely to lie (as Al-Qaeda in Iraq discovered) with its ability to maintain financial relationships with the population it now controls than with the disrupting efforts of the international community.

1. This article uses the term Islamic State for the group known variously as the Islamic State of Iraq and Al-Sham (ISIS), the Islamic State of Iraq and the Levant, or its Arabic acronym Da’esh.
2. Ackerman, Spencer. “‘Apocalyptic’ Isis beyond Anything We’ve Seen, Say US Defence Chiefs.” *The Guardian*. <http://www.theguardian.com/world/2014/aug/21/isis-us-military-iraq-strikes-threat-apocalyptic>
3. Hagel, Chuck (2014), *Transcript: Hagel Testifies to the Senate Armed Services Committee on the Islamic State* http://www.washingtonpost.com/world/national-security/transcript-hagel-testifies-to-the-senate-armed-services-committee-on-the-islamic-state/2014/09/16/a4909e26-3dab-11e4-b0ea-8141703bbf6f_story.html
4. United Nations Security Council (2014), <http://www.un.org/News/Press/docs/2014/sc11580.doc.htm>
5. Manuwald, Gesine (ed) (2007), *Marcus Tullius Cicero, “Orations Philippicae III-IX”* p202-203, (Walter de Gruyter & Co: Berlin).
6. Adams, James (1986), *The Financing of Terror* (Sevenoaks: New English Library).
7. Horgan, John & Max Taylor (1999), ‘Playing the Green Card’: Financing the Provisional IRA – Part 1’, *Terrorism and Political Violence*, Vol. 11, No. 2, pp1-38.
8. Dalyan, Sener (2008), ‘Combating the Financing of Terrorism: Rethinking Strategies for Success’, *Defence Against Terrorism Review*, Vol. 1, No. 1, pp137-153.
9. There is evidence that Iran provides some support and sanctuary to elements of Al-Qaeda although this is not meaningful in the context of the financial operations of Al-Qaeda and Islamic State-related groups.
10. Garry, Tom (2013), *Would the 9/11 Hijackers’ Money Trail Raise Red Flags in Today’s System?* (Foreign Policy Association) <http://foreignpolicyblogs.com/2013/09/06/would-the-911-hijackers-money-trail-raise-red-flags-in-todays-system/>
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Money and War in Afghanistan

Corruption as the Hidden Enemy of Mission Success

BY Emily Knowles / Karolina MacLachlan



Afghan National Police Academy (ANPA) cadets learn how to shoot VZ 58 rifles at a weapons training class. Traditional ANPA training is three years, but the academy has recently created an accelerated, six-month course due to high demand for more law enforcement officers throughout Afghanistan. The academy trains men and women from more than 34 provinces (Staff Sgt. Sarah Brown, U.S. Air Force).

The Vicious Cycle

Corruption, instability, and conflict tend to go hand in hand. Twelve of the fifteen lowest-ranking countries on Transparency International's Corruption Perceptions Index are currently experiencing violent insurgencies, extremist activity, or other signs of deep-seated instability.¹ Systemic, embedded corruption is a thread that runs through such seemingly disparate events as the outbreak of the Arab Spring, the conflict in Ukraine, the failure of the Malian army in 2012, the growth of Boko Haram in Nigeria, and the retreat of the Iraqi security forces in the face of ISIS. However, the effects of corruption are not limited to exacerbating the risk of conflict; corruption also makes it more difficult for states to respond to threats and for international institutions and other actors to offer effective assistance.²

Assistance to fragile and failing states tends to include two types of engagement: international peacekeeping and/or stabilization

operations and defense capacity building (i.e. assistance to the recipient states' security forces). But without anticipating and mitigating the risks that corruption poses, the international community risks the intent of security assistance being subverted, the assistance wasted, and the success rate of stabilization operations being severely impaired. In particular, misappropriation of funds, vanishing resources, and a reliance on malign power-brokers can irreparably damage the operational success of a mission.

This article is based on the research investigating the international community's approach (or lack thereof) to tackling corruption in Afghanistan carried out by Transparency International UK's global Defence and Security Programme (TI-DSP) and based on over 75 interviews with civilian and military officials. This work is supported by insights from TI-DSP's long-term engagement in the Building Integrity training for the Afghan National Army and Afghan National Police.³ In the resulting

report, we argue that corruption has had a significant impact on ISAF mission success and that the international community's reaction to corrupt practices was too little, too late. We point to three main ways in which corruption and uncontrolled money flows can diminish the effectiveness of the mission and offer a planning and risk assessment framework as the first step toward addressing corruption risks on operations.

Corruption of Operations: Three Pitfalls

The need for a thorough evaluation of the threat that corruption poses to our models of stabilization is clear if we look back at the experience of the international mission in Afghanistan. There are three key ways in which money and war can become locked into a symbiotic relationship that perpetuates state vulnerability to violence and undermines stabilization efforts:

1. Pumping project funds – whether civilian or military – into unstable environments without adequate controls;
2. Operating in kleptocratic systems; and
3. Investing in security sector reform (SSR) in war-torn states without taking corruption into account

Issues of international funds, instability, kleptocracy, power struggles and SSR were deeply linked in Afghanistan. It is time that policy makers and operational planners start taking these issues into account, and examining how they can be addressed. In an interview for TI-DSP's study on Afghanistan, an anonymous interviewee urged future policy planners to "see if they can get to a more inclusive political order through how we spend our money, with how we engage, which leaders we empower and really understand the drivers of... conflicts".

1. Pumping project funds – whether civilian or military – into unstable environments without adequate controls

In the course of our research on Afghanistan we have repeatedly come across concerns over the use of "burn rates"—the amount of money spent—as the criterion for assessing commitment and success. At times, the desire to be seen "doing something" can override legitimate concerns, including those surrounding accountability and corruption.

The "doing something" mentality can hurt monitoring and evaluation, two key tools for reducing corruption risk. When inadequate controls are in place, it can mean that large sums of money from the international community are allowed to change hands in extremely unstable and factionalized environments. This can have the knock-on effect of empowering malign actors, fuelling power struggles, and enriching a few to the detriment of the security of the majority.

The scale of this problem became steadily apparent in Afghanistan, but only limited measures were ever introduced to tackle it. The painstaking tracing of aid and contracting flows in Afghanistan undertaken for the 2010 'Warlord, Inc.' report to Congress showed that due to lack of safeguards and tracing, U.S. military funds were indirectly reinforcing the coffers of warlords and insurgents.⁴ The report prompted public outcry, resulting in the creation of Task Force 2010, an inter-agency force tasked with tracking corruption and fraud among contractors. The task force had considerable success in identifying problem contracts and encouraging better behavior, but its mandate was never extended to cover contracts held by



U.S. Soldiers fortify an Afghan police checkpoint by placing razor wire around the perimeter in Robat, Afghanistan, March 19, 2010. The soldiers are from Bear Troop, 8th Squadron, 1st Cavalry Regiment (Tech. Sgt. Francisco V. Govea II, U.S. Air Force).

**“ [T]he only way currently to demonstrate that [something] is a priority is by budgeting more money for it.”
- Anonymous interview**

non-U.S. firms. Overseeing contracts also fell outside the mandate of the specialist anti-corruption agency Shafafiyat, leaving financial control mechanisms completely inadequate for such a challenging and unstable environment.⁵

Given the potential for non-monitored funding to fuel instability and subvert the intent of aid, achieving concrete project goals must take priority over the speed and scale of funds being distributed. The message “Spend less, and spend transparently” should be taken up by policy planners as the international community looks back at a decade and a half of engagement in Afghanistan. Stronger oversight, combined with the right mind-set, can help prevent such large-scale misappropriation of international funds.

2. Operating in kleptocratic systems

One of the deepest and most painful lessons from Afghanistan is that once corruption reaches a certain level, it ceases to be an aberration of the system and becomes the system itself. For example, the buying and selling of posts in the Afghan National Army has led to a cycle of extortion becoming institutionalised. High-ranking officials exacted money from those below them to pay off loans for their positions; those below them in turn offset their costs by shaking down citizens.⁶ When high levels of systemic corruption prevail, oversight over resources and the integrity of institutions becomes increasingly challenging.

Research aiming to calibrate the scale of ‘kleptocratic’ state capture and its impact on national and international security is still in its initial phase, but it is already clear that where corruption grows into kleptocracy, the state can be hollowed out until illicit flows of money are the only vehicle keeping the state running.⁷ Directly paring institutionalized factionalism, or the control of state resources for the benefit of a few over the majority, with the outbreak of civil violence, has a 50% success rate in predicting instability.⁸

When state structures are captured, the influx of money from external sources is likely to fuel the system.⁹ The first step in addressing this problem is to understand the political nature of corruption, and to map power flows and the distribution of resources in a country. Once this understanding is developed, planners can more accurately develop mechanisms to provide funds without allowing systemic corruption to undermine their efforts at stabilization.

“[I]f you removed corruption from the Afghan government, it would collapse. Corruption is sustaining the network.”
-Anonymous interview

3. Investing in SSR in war-torn states

Corruption and lack of transparency in the defense and security sector can be particularly pernicious as it undermines a state’s ability to protect its citizens. Where corruption is present in defense and security forces, these forces can themselves become a threat to the personal security of the population. Tackling corruption in post-conflict states’ security forces is a particular challenge, as it often requires not only specific anti-corruption training, but also basic institution-building measures to be implemented. Systemic corruption at the top compounds the problem as it often prevents the payment of fair and regular salaries, which in turn begets need-based corrupt behavior.¹⁰

A major concern to come out of the Afghan experience was that developing technical and operational capabilities and the provision of equipment were prioritized over the broader development of the security sector. As a result, there was too little focus on developing the administration, systems and structures to support the sustainability of the sector. One concern is that the rapid rotation of the international military training staff restricts institutional learning, meaning that opportunities to streamline the process of reforming the security sector are limited.

“The person who discovers a way of training a police force in a post-conflict country would deserve a Nobel Peace Prize.”
-Anonymous interview

Factionalism, nepotism and patronage can quickly take root where institutional structures are weak or lack legitimacy. Investing large sums of money into building and training security forces in post-war environments without taking care to build integrity into both the institutions and the training of personnel leaves the sector at risk of remaining corrupt and unable to provide a stabilizing presence on the ground once international forces leave and oversight is dramatically reduced.

Policy Proposals for the Future

1. Be explicit about the threats from corruption from the outset

Getting anti-corruption measures into mission mandates is paramount. In addition, mapping financial flows and powerbrokers should be a key aspect of planning a mission so that measures can be put in place to mitigate the risks they pose. Once an operation is fully underway, changing course becomes increasingly difficult.



Afghan National Army Maj. Gen. Khatoll Mohammedzai answers questions from public affairs photojournalist Sgt. Christopher Harper during the lunch break at the Shafafiyat sponsored International Women's Day event honoring the brave women of Afghanistan at International Security Assistance Force headquarters, Kabul, Afghanistan, March 7, 2012. Shafafiyat, an Afghan word which means "Transparency" in English, is an ISAF agency which works with community leaders to combat corruption (Maitre Christian Valverde, French Navy, ISAF headquarters Public Affairs Office).

2. Better equip policy makers and implementers

Corruption as a risk to stability is coming to the fore, in particular due to the attention paid to events in Iraq, Nigeria, and Afghanistan. Those in charge of developing policy and running operations must have resources and access to information in order to fully understand corruption risks.

3. Ensure robust international alignment

Military, diplomatic, and aid communities need a unified policy line on addressing corruption threats on international missions. Without coherence and cooperation across the full spectrum of assistance-givers, robust policies that are able to withstand the pressures of an unstable environment cannot emerge, leaving international responses to corruption threats disjointed and ineffective.

4. Spend less, and spend transparently

Money is not always a solution and can, as discussed above, en-

able and entrench corruption. Spending decisions should be made carefully, subject to detailed oversight, and made public. Transparency is a requirement for accountability.

5. Maintain oversight and transparency

One of the greatest innovations to come out of the intervention in Afghanistan was a joint national-international, independent committee of experts to monitor and evaluate national progress on anti-corruption initiatives (MEC).¹¹ This body, supported by a strong secretariat, provides a unique model of reporting to the public, Parliament, President, and international community, providing the pressure required to maintain an appetite for tough reforms.

These changes are the minimum necessary to make meaningful progress in tackling corruption and its impact on international security and stability. Above all, those who plan and execute military interventions and security assistance programmes must view both preventing and fighting corruption as an integral part of the mission throughout its duration.

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Karolina MacLachlan joined TI-UK DSP in August 2014 and is the main point of contact on research and policy issues. She earned her PhD at the Department of War Studies, King's College London, and has extensive research and university teaching experience in security and defence issues. Prior to joining TI-UK DSP, she worked at the House of Commons, managing inquiries for the Environmental Audit Committee.



Local Afghan village elders sit in on a scheduled council meeting with U.S. Marine Capt. Kenneth J. Del Mazo, Commanding Officer Battery I, 3rd Battalion, 10th Marine Regiment (3/10), held at the local administrative building outside Patrol Base Mahafiz in Shorshorak, Afghanistan, April 29, 2010. The Marines and sailors assigned to 3/10 in support of the International Security Assistance Force (Cpl. Logan E. Riddle, U.S. Marine Corps).

Pulling Apart at the Seams

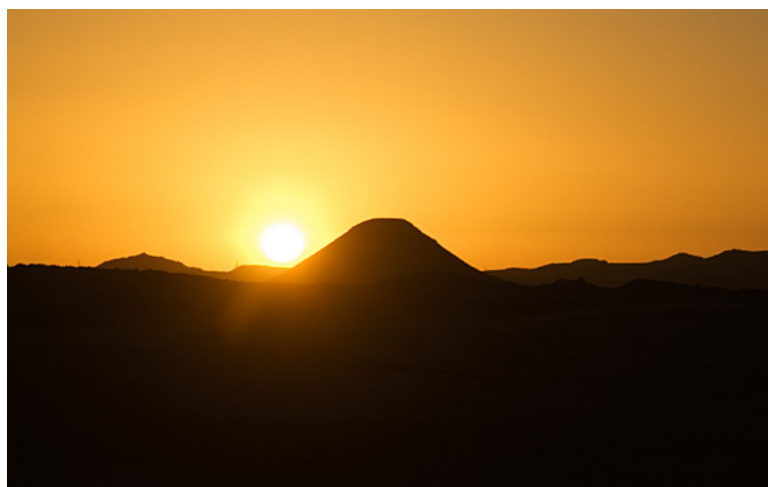
Smuggling, Narcotics, and Governance in the Sahel

BY **Andrew Lebovich**



The jihadist takeover of northern Mali in mid-2012 caught many regional observers by surprise. For years, al-Qaeda in the Islamic Maghreb (AQIM) and later the AQIM splinter group, the Movement for Oneness and Jihad in West Africa (MUJAO in French), were seen largely as smugglers, criminals, and “narco-traffickers.” This perception led to a curious process by which some analysts dismissed the risk posed by these groups, while others (chiefly, Western governments) developed a near obsession with the prospect that money from smuggling operations, particularly drugs, would finance jihadist activity in the Sahara and Sahel.¹ While regional experts have since aggressively critiqued the notion of extensive ties between Sahelian militant groups and smuggling, particularly in the narcotics trade,² it is nonetheless important to assess the extent of these connections and how they fit into a larger regional context.

The purported link between cocaine trade and militant groups gained traction among outside observers due to the appearance of both in northern Mali at approximately the same time. Cocaine first began circulating through and in northern Mali in the early 2000s, while the group that would become AQIM, the Salafist Group for Preaching and Combat (GSPC), achieved notorious renown in 2003 with the kidnapping of 32 Europeans in southern Algeria.³ Analysts also focused extensively on cocaine, despite the large circulation through and within the region of cannabis products, amphetamines, and other drugs.⁴



However, the rise of smuggling networks and economies in the region long preceded the arrival of jihadist militancy. As anthropologist Judith Scheele and others have noted, smuggling in northern Mali began in the 1960s and 1970s with the trade in foodstuffs, especially powdered milk and pasta produced in Algeria, which was then resold in Mali and northern Niger.⁵ In the 1970s, 1980s, and 1990s, illicit or semi-licit (grey market) trades emerged, including the smuggling of subsidized petrol from Libya and Algeria into the Sahara, as well as the two-way move-

Top: SUVs race across the Ghadames Desert in Libya. Similar methods are used to traverse this desolate landscape (gordontour, Flickr.com). **Left:** A colorful sunrise paints the Sahara Desert in a palette of yellow (Dallas75, Flickr.com).

ment of weapons, counterfeit or contraband cigarettes, and people.⁶ This smuggling was itself part of an older process in a region that has always depended on the circulation of people and goods for survival.

As AQIM began operating in the Sahara, their commanders, especially Mokhtar Belmokhtar and Abdelhamid Abou Zeid, forged close social and economic relations with local populations. Belmokhtar, an Algerian from the pre-Saharan city of Ghardaia, adapted particularly well to this environment, marrying a Bérabiche Arab woman from a prominent family in the Timbuktu region.⁷ Their groups additionally took part in the economic circuits of the region, ingratiating themselves by reportedly paying more than market price for goods, conducting outreach to local populations in the form of gift-giving, and even providing medical care on some occasions.⁸

These and other jihadist figures also integrated themselves into the local illicit economy, which was quickly growing distorted with an influx of new cash. Part of this influx was certainly from the drug trade, which grew significantly after 2004 and 2005,⁹ and may have reached its peak with the infamous “Air Cocaine” incident, in which a burnt-out husk of a jumbo jet was found in the desert north of Gao, having purportedly discharged a multi-ton cargo of Latin American cocaine.¹⁰ However, much of the cash influx can be attributed to ransom payments to AQIM (and after late 2011 MUJAO as well), with some estimates as high as \$100 million since 2003.¹¹ This money passed through the hands of local interlocutors involved in the negotiations process, many of whom were close to then-President Amadou Toumani Touré. In the latter years of his presidency, and especially after a renewed outbreak of the Tuareg rebellions in 2006, Touré delegated enormous governance duties in the north to local notables (some of whom later became rebels or returned to rebellion) as well as militias recruited on ethnic grounds. This strategy of “remote control,” to use the words of the International Crisis Group, when combined with



The Sahel is a transition zone between the arid north and the tropical green forest that borders the maritime coast, covering a surface area of 5.4 million km². Vegetation in the Sahel region is composed of mainly stunted and scattered trees, shrubs, bushes and grasses. Sahel, Africa (Daniel Tiveau, Center for International Forestry Research).

the large amounts of money suddenly flowing into the region, weakened and destabilized governance in northern Mali in the years preceding the 2012 Mali crisis.¹²

AQIM, and later MUJAO, benefitted from this destabilized environment, which they also helped shape. In 2009, for instance, AQIM fighters murdered the Bérabiche Arab commander, Colonel Lamana Ould Bou, in his home in Timbuktu, supposedly after a failed arms deal.¹³ Ould Bou was a former rebel from the 1990s, and deeply enmeshed in narcotics trafficking. He was also very close to the then-head of Mali's state security services, Mami Coulibaly.¹⁴

However, AQIM was far from the only factor in these economic circuits. Money from the growing illicit trades helped fuel electoral conflict in towns like Bourem and in the Gao region,¹⁵ propelling the rise of formerly subordinate or “vassal” Arab and Tuareg groups like the Bérabiche, al-Amhar (sometimes written as “Lamhar”) Arabs from the Tilemsi Valley in the Gao region, and Imghad Tuareg.¹⁶ This led to growing

conflict in voter rolls and also in actual violence, as Imghad Tuareg increasingly challenged prominent members of the Ifoghas and Idnan clans, while Bérabiche and Tilemsi Arabs repeatedly challenged the Kounta people.¹⁷ Many of these conflicts, over politics, trade routes, and the past, were exacerbated with the return of Tuareg fighters from Libya, though the Libya conflict did not “cause” the rebellion in northern Mali as many suggested at the time.¹⁸

The leaders of these militias, all former rebels who had integrated into the army in the 1990s (Ould Bou, Colonel Mohamed Ould Meydou, and Colonel El Hajj Ag Gamou) were all rumored to be traffickers,¹⁹ though that is a common refrain when talking about prominent figures in northern Mali that rarely comes with evidence. Still, while Ag Gamou's fighters would stay aligned with the Malian government during the 2012 rebellion, some fighters from Ould Meydou's group and

other Tilemsi Arabs quickly joined MUJAO, which was itself founded in part by Sultan Ould Badi, a man of partial Arab descent.²⁰ The presence within MUJAO of Ould Badi, known previously as a trafficker, as well as other reputed Tilemsi Arab traffickers like Cherif Ould Taher, led some observers to see the group as a front of sorts for economic activities.²¹ However, others have argued that the group's behavior before and after the fall of northern Mali demonstrated a clear commitment to jihadist ideologies and methods,²² and Ould Badi's fighters have been among the most present in the recrudescence of violence in northern Mali in recent months.²³

This brings us to two challenging issues regarding our understandings of militancy and trafficking in the Sahara-Sahel, and more particularly in northern Mali. On the one hand, militant groups like AQIM were deeply involved in some aspects of the illicit trade in northern Mali, benefiting from the trade as well as highly decentralized governance. However, despite many accounts of AQIM involvement in smuggling, few have ever been truly substantiated. Indeed, informed observers have suggested that AQIM's involvement in smuggling was largely limited to taxation and possibly protecting convoys, rather than running drugs or even cigarettes themselves.²⁴ Indeed, Belmokhtar, nicknamed "Mr. Marlboro" in the press for his supposed involvement in the cigarette trade, vehemently rejected those charges in a 2011 interview.²⁵ Moreover, a recent book by the Mauritanian journalist Lemine Ould Mohamed Salem, who traveled extensively throughout northern Mali during the jihadist occupation of the north in 2012, argues that there is in fact no evidence to substantiate charges of his involvement in drug and cigarette trafficking, but rather that he was more closely involved in smuggling fuel and foodstuffs.²⁶ Government officials have also suggested that in the past, as much as 90% of AQIM's finances came from ransom payments,²⁷ rather than trafficking, indicating significantly less militant involvement in illicit trade than many thought and continue to think.

“[T]he centrality of smuggling and cosmopolitan travel and trade to the economy and social fabric in northern Mali present immense concerns and potential pitfalls for policymakers.”

The other problem is the very complexity of social and economic relationships in the north, especially as it relates to trafficking. In addition to being a necessary form of economic activity, trafficking has licit and illicit cargoes, while also allowing individuals or groups of people increased social, economic, and political independence.²⁸ Moreover, the ubiquity of trade and different ways of understanding in northern Mali mean that traders and traffickers do not always carry the same moral weight as Western audiences give them. In her anthropological work in northern Mali on the smuggling trade, Scheele noted that while the trade

in drugs is seen as haram in ways that other trades are not, traders still move easily between “licit” and “illicit” smuggling.²⁹ She also recounts the interaction between a trafficker and his cousin, another “businessman” known for his religious values. When the latter explained to Scheele why the former was not “beyond saving,” he argued, in Scheele’s words, that “Drug smuggling is thus a crime against humanity, whereas not praying is a crime against God, and thus infinitely worse.”³⁰ This latter point provides insight into the overlapping identities present in the region, and the ways in which someone could perhaps be an observant Muslim, or a jihadist, as well as a smuggler or “criminal” in Western parlance. We should thus proceed with caution in making anachronistic or skewed judgments and analyses of events and allegiances in very different cultural and political environments.

Borders drawn across the Sahara disrupted old trade routes, and gave rise to others. However, the centrality of smuggling and cosmopolitan travel and trade to the economy and social fabric in northern Mali present immense concerns and potential pitfalls for policymakers. It is important for analysts to gather as much information as feasible on these networks so as to avoid past mistakes, when aid, governance responsibility, and lucrative contracts fell into the hands of “businessmen” who sped the rot of governance in northern Mali. These concerns are particularly important amid ongoing peace talks in Algeria between the Malian government and the country’s armed groups.³¹ It is also vital that regional and Western military actors, especially the French Armed Forces, understand the complexity of these networks, so as to avoid killing civilians who find themselves in or near militant or smuggling convoys.³² This is not an idle concern; the establishment of French military bases across the Sahel under the auspices of Operation Barkhane, including in Madama in northeastern Niger near the smuggling hub of southern Libya, appear to be aimed at least in part at targeting smuggling networks.³³ As Saharan populations have suffered enormously due to conflict and instability in the region, everything possible must be done to prevent a deterioration of the situation.

1. See for instance “Africa Under Attack: Drug trafficking has acquired a whole new dimension,” *United Nations Office on Drugs and Crime*, December 8, 2009. <https://www.unodc.org/unodc/en/about-unodc/speeches/2009-08-12-africa-under-attack.html>; also see Dario Cristiani, “Al-Qaeda in the Islamic Maghreb and the Africa-to-Europe Narco-Trafficking Connection,” *Jamestown Terrorism Monitor*, November 24, 2010. [http://www.jamestown.org/single/?no_cache=1&tx_ttnews\[tt_news\]=37207#.VFvwohlawrw](http://www.jamestown.org/single/?no_cache=1&tx_ttnews[tt_news]=37207#.VFvwohlawrw)

2. One particularly astute analyst of the relationships between various groups and illicit trade in the region is Wolfram Lacher. See Wolfram Lacher, “Challenging the Myth of the Drug-Terror Nexus in the Sahel,” *West Africa Commission on Drugs*, August 19, 2013.

3. “German plea over Sahara tourists.” BBC News. 12 May 2003. BBC. Web 7 Nov. 2014 < <http://news.bbc.co.uk/2/hi/africa/3020131.stm> >

4. Since October 2014, security forces in Niger, Burkina Faso, and Mauritania have reportedly seized several tons of cannabis, suggesting that at least some narcotics trafficking continues to operate in the region. Authorities in Niger also seized nearly 6 kg of cocaine at the main airport in Niamey, Niger in April and December 2014, as well as a larger amount of

- cannabis. See “Mauritanie: L’armée abat deux trafiquants de drogue près de la frontière algérienne,” *Koaci*, December 19, 2014. <http://koaci.com/mauritanie-larmee-abat-deux-trafiquants-droque-pres-frontiere-algerienne-97313.html>; “Burkina Faso: Plus de 7 tonnes de chanvre indien saisis à la frontière du Mali,” *Koaci*, October 20, 2014. <http://koaci.com/burkina-faso-plus-tonnes-chanvre-indien-saisis-frontiere-mali-97349.html>; Aishu Manga, “3,5 kg de cocaïne saisie à l’aéroport de Niamey,” *Sahelien.com*, April 15, 2014; Omar H. Saley and Maria Coulibaly, “Niger: La police a saisi plus de 2 kg de cocaïne à l’aéroport de Niamey,” *Sahelien.com*, December 23, 2014; Olivier Fourt, “Niger: Madama, base de la lutte contre les trafics,” *Radio France Internationale*, January 1, 2015. <http://www.rfi.fr/afrique/20150101-niger-france-madama-barkhanele-drian-libye/>
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Trading Security

A Case Study on Maritime Security Decision Points in the Context of Global Trade

BY **Caroline Troein / Anne Moulakis**



A cargo ship leaves Harbor Beach, Florida, towards the Panama Canal and a trans-Pacific journey (Michael Bentley).

Introduction

The term maritime security often evokes destroyers and aircraft carriers, disputes over territorial waters or islands, or piracy and terrorist attacks such as the USS Cole bombing in 2000. In the security world, we less often think of the millions of items ferried across the sea, from mundane automotive parts to exciting new toys. High profile crises can lead us to forget that maritime security is an everyday event; it is about enabling safe transit. Each step within the maritime transport of goods has security challenges and considerations. At the same time, the continued stability and effectiveness of maritime trade is itself a broader security matter of importance to consumers, businesses, and governments. With the “weaponization of finance”¹ maritime trade will play a central role in economic actions being taken out of geopolitical concerns.

International maritime trade works so well and inexpensively that the cost of freight transport is a marginal consideration in deciding where to source or market goods.² Though the maritime transportation network functions amazingly well, its complexity and interconnectedness make it vulnerable to disruption. Disruptions within the international maritime trade network can cause far more than inconvenience if not addressed rapidly and intelligently: they can affect the fundamental supply chain

that supports commerce and national economies, and thus affect the geopolitical interests as well as the stability of states.

As a result of maritime trade’s effectiveness, it is often invisible. Most end consumers and businesses are indifferent and unaware of how goods get to them. They merely want and expect their products to arrive inexpensively and reliably. Consumer expectations have been fed by maritime trade’s sustained success and integral contributions to the global economy. Maritime shipping carries 80%-90% of the world’s goods, by volume.³ Globalization, facilitated by trade liberalization, has led to the dispersion of manufacturing and retail sites across vast distances, the rapid worldwide adoption of just-in-time inventory control and tight supply chain management. The low cost of shipping has further encouraged the dispersion of manufacturing and retail: shipping costs as a percentage of final good price has consistently fallen over the past fifty years, and in 2004, accounted for only 3.6% of the value of global imports.⁴ Efficient and timely maritime transportation has become central to economic competitiveness for both individual businesses and national economies. It is the maritime movement of goods, enabled by maritime security, that makes the modern global economy possible.

The question of maritime security involves far more than just keeping bad people from doing bad things. It also involves keeping this essential, highly interconnected transportation network operating efficiently and reliably. It is very similar to the importance of the world's financial system. These are "Critical infrastructures" par excellence. Security concerns around Critical infrastructure are high, but also need to be addressed with nuance and an awareness of the effects on the broader network.

By following a hypothetical trip of widgets from China to Nebraska, we can get a sense of the complex web of activities required to move the world's goods. The process outlined by this hypothetical is multiplied over a myriad of companies and thousands of departure-destination combinations. The resulting interconnectedness generates repercussions far beyond individual shipments or transits. Thus, husbanding the "resource" of maritime trade is as much a security matter as an economic one.

Individual business maritime trade decisions are mostly about maximizing profit and minimizing cost. But the effect of these decisions is far wider; the stability and efficiency of maritime trade affects those profit-based decisions and, by extension, national economies. Maritime trade affects nearly every business and consumer, therefore any problems with that trade can quickly lead to political and security concerns. It is incumbent upon policy makers, port authorities, and maritime companies to invest in the continued stability and resiliency of maritime trade.

Hypothetical: From China to Nebraska, By Sea

Your company will be ordering widgets from a manufacturing hub in China. You need to get two containers of these widgets to the US cost effectively, without excessive time delay, and with a minimum of risk. This shipment is important to your company.

Ports

During its journey, a single container goes through multiple facilities, vessels, and ports. Securing it against tampering, theft, and misuse is very challenging.⁵ Ports are central to the security mechanisms in place to protect maritime trade. The quality and efficiency of port security can have a significant impact on port operations and reputation, and thus on user choice of port.

However, the commercial choice of departure and destination port will be most directly influenced by a port's connectivity with other world ports, ease of access to and from the interior it serves, and cost in terms of port fees, taxes, and customs procedures.

Leaving China

Departure port choice is driven by the port's connectivity to manufacturing centers and destination ports, the port's relative efficiency at getting ships loaded and under way, and the costs involved. Each of these elements play into and are affected by port reputation. Part of a port's reputation is its security posture. Questions of corruption or lax security enforcement can rapidly lead shippers to move their business elsewhere.

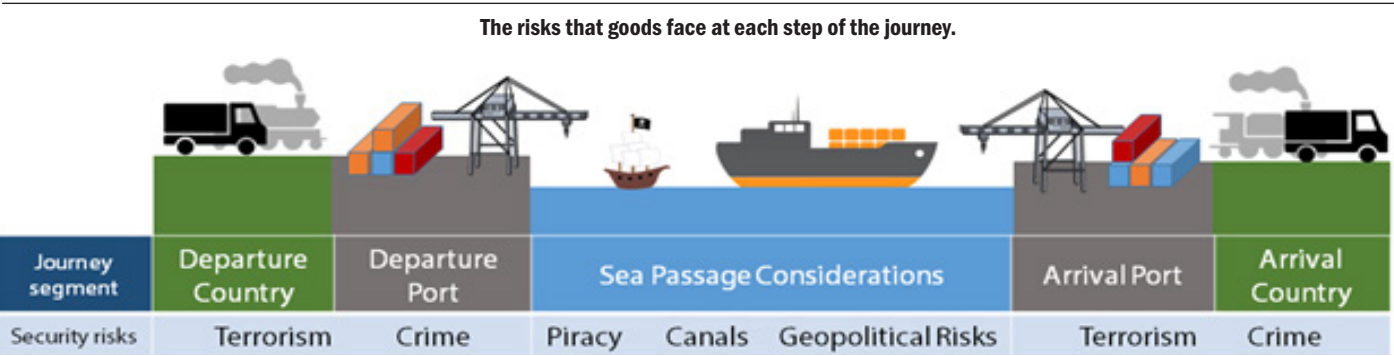
The top Chinese ports provide rapid, cost effective, and frequent service. China's central and regional governments view the ports as essential to China's continued economic development. Therefore any disruptions, whether political, logistical, or security related are likely to be addressed quickly.

China is home to most of the world's biggest and busiest ports, with six of the world's 10 busiest ports in 2012 leaving no shortage of choices for departure.⁶ While overall trade and transport-related infrastructure, other than the ports themselves, is less developed than in OECD countries, it still is fairly good. The greatest weakness of China's ports is the relative inefficiency of customs. Import and export procedures take up to four times as many days as they do in the US, though they are cheaper.⁷

Our widgets are likely sourced from the two main coastal economic areas in China. These are the Yangtze River Delta, served by Shanghai and Ningbo-Zhoushan ports, and the Pearl River Delta, served by the ports of Hong Kong, Guangzhou, and Shenzhen. As of 2013, Shanghai and Shenzhen were the ports with the highest throughput of containers.⁸ Combined with their proximity to key economic areas, they are the most likely departure port choices for our shipment of widgets.

Entry to the United States

There are three regions of entry to the US for maritime shipments: the West Coast, the East Coast, and the Gulf Coast. Deciding upon a US point of entry determines what routes are



preferable. The point of entry will determine the final over-land transit of our widgets, and will depend on cost, time, and reliability.

Los Angeles and Long Beach are two contiguous ports that, combined, have by far the largest throughput for North America and are the primary entry-point to the US for goods from Asia. In 2012 they held 42% of the US container port market.⁹ They are equipped to handle the largest container ships and are linked to the rest of the country by a robust rail network into the American heartland.¹⁰ However, over the last year, the West Coast has suffered port congestion due to a combination of factors. In 2014, renegotiation of the labor contract with the International Longshore and Warehouse Union began. The negotiations are contentious because of significant moves toward greater automation at the ports of Long Beach, Los Angeles, and Oakland. Combined with a shortage of trailers used to haul cargo from the ports to inland warehouses, these tensions have led to “the worst shipping crisis in a decade.”¹¹

The port of New York/New Jersey is the next largest, handling 16% of the US container market.¹² The expansion of the Panama Canal is expected to lead to an increase in traffic, especially if congestion continues to be high at Los Angeles and Long Beach. The port of New York/New Jersey is served by three major rail carriers and has invested in improving its rail and barge intermodal connectivity by developing a Port Inland Distribution Network.¹³ However, road distribution is hampered by the port’s location along one of the most congested transportation corridors in the country.

On the Gulf Coast, the port of Houston is termed the “most indispensable port” because of its strength in container throughput, vital role in the US petro-chemical industry, energy, security, and inland infrastructure.¹⁴ The port of Houston can receive the largest container ships and can effectively distribute the incoming cargo along rail, road, and waterways.

Choosing any of these ports has tradeoffs and consequences. Los Angeles and Long Beach have the benefit of having handled large volumes for many years and of having strong rail connections which travel through less dense parts of the country allowing for longer trains and double-stacking of containers. On the other hand, labor problems combined with insufficient trucking capacity and major eastbound rail already operating near or at capacity pose challenges to the smooth flow of goods.¹⁵ Houston has similarly strong inland access, including waterway access giving it potentially greater flexibility. Yet to date, most of the containers coming through the Port of Houston are destined for relatively close distribution. The Port of New York/New Jersey is located in one of the most densely populated corridors, creating congestion concerns but also leading to the majority of containers remaining within the region.

The commercial decision regarding which port to use will primarily be driven by convenience factors such as the time it takes to process the cargo and get it on its way inland as well as the

relative cost of inland routes and connections. Though these decisions are not based primarily on security considerations, they are influenced by any security measures taken to protect ports and container safety. Smooth operation of customs and efforts to maintain the security of containers affect how desirable a port is.

Port Related Security Concerns

Ports are central nodes in the complex network of interdependent systems that need to operate effectively, efficiently, and in collaboration with each other to maintain the free-flow of goods that national economies rely upon. Maintaining the resiliency of this network is as much a security concern as a commercial one. It involves safeguarding port connectivity inland and across the oceans.

Security, when it relates directly to ports, has two component parts: securing the port itself and securing the goods in the supply chain the port participates in. Physical protection of ports and the access to them is as old as ports themselves. Historically, the threats to ports came in the form of attack by other nations or criminal elements, with the aim of either gaining control over the port or crippling it to deprive the owners of its use.

The attacks of 9/11 brought greater attention to the idea of ports as conduits for terrorist, as well as criminal activities. As a result, the US introduced a series of laws to improve port security against terrorism. The provisions in the US legislation, the November 2001 Customs and Trade Partnership Against Terrorism, the 2002 Container Security Initiative, and the 2006 Security and Accountability For Every Port Act were widely adopted through multilateral agreements by countries around the world.¹⁶

Over the same period, the United Nations International Maritime Organization drafted and approved a comprehensive security regime for international shipping, the International Ship and Port Facility Security Code (ISPS). The ISPS extends existing code governing state and private sector responsibilities with regard to safety at sea to include vessel security and port security. It entered into force on July 1, 2004.¹⁷ Many countries have taken significant steps towards implementing the requirements outlined in the Code.¹⁸

The US agreements and ISPS are not the only frameworks for port security. The International Organization for Standardization has also issued international risk management standards for port authorities. Many individual port authorities, including those at the major Chinese and US ports, are increasingly working to comply with the various international security standards and procedures, in part as a way to remain competitive, as well as demonstrating they are operating at a world-class level.¹⁹

After 9/11, the initial focus of effort to bolster port security was primarily on ports as conduits, aimed at improving supply chain visibility and security. However, in recent years, attention shifted

to the possibility of ports as targets of attack by non-state actors. As a result, many nations, including the US, have been incorporating ports into security planning for the protection of “Critical Infrastructure.”²⁰ The shift in mindset from ports as conduits to ports as potential targets builds upon supply-chain security efforts. Integrating ports into “Critical Infrastructure” planning recognizes the fundamental role they play in national economies. It provides a framework for planning and investment that takes into account economic and security elements at both the municipal and national level.

Security Considerations at Sea

The recipients of goods rarely see the broader geopolitical security environment within which maritime trade operates. A business ordering parts from China is focused on profit maximization. As long as goods are delivered reliably and cost effectively, the logistics of delivery is left to freight forwarders and shipping companies. While companies do not take the direct decisions affecting their cargo at sea, they buy into the importance of maritime trade and become part of maritime security matrix.

The shipping company itself, based on cost, time, reliability, and security risk, determines shipping routes. For example, the most direct route between the US and China is the Pacific Ocean to the US West Coast, avoiding geopolitical conflicts and piracy. Routes between the US East Coast and China can require passing through paid canals, incurring costs, limiting ship size, and introducing potential political pressure. Ships sailing towards

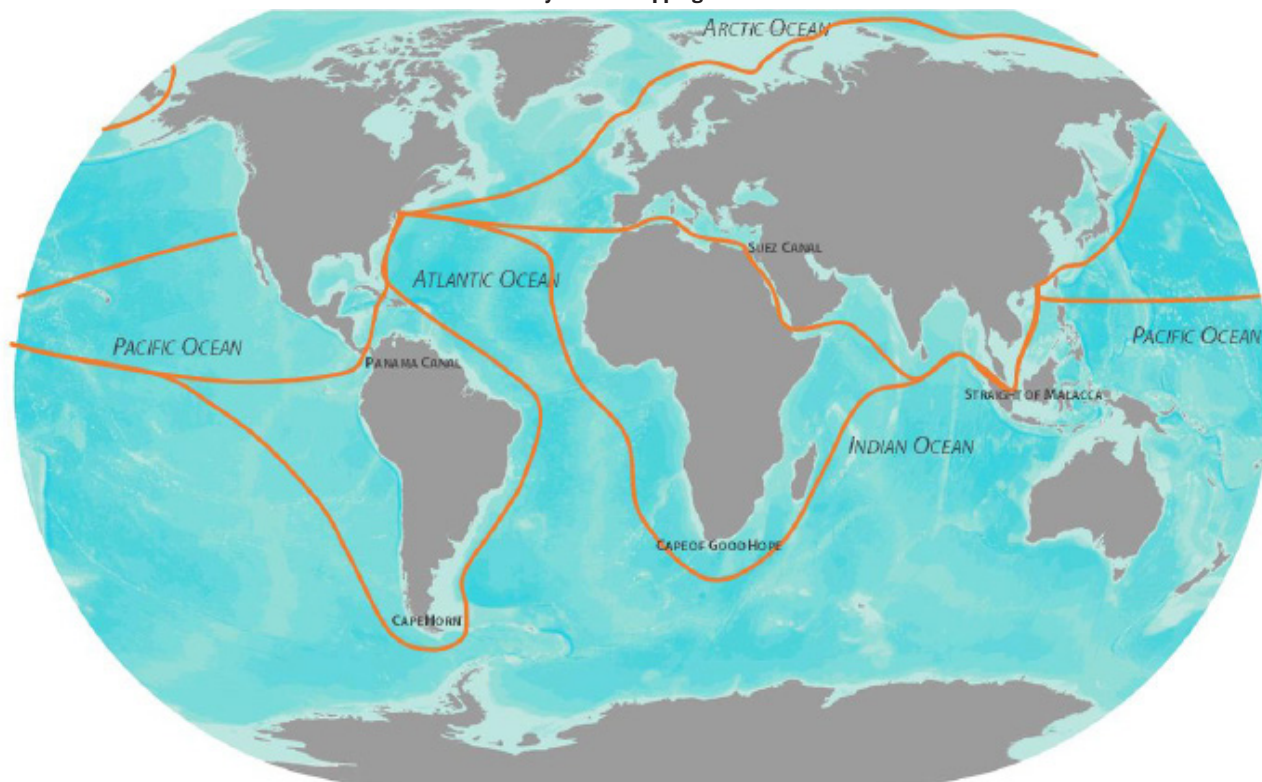
the Suez Canal or Cape of Good Hope must pass through the Strait of Malacca and the eastern coast of Africa, exposing both ship and cargo to the risk of piracy. Travelling around the southern tip of South America avoids tolls and pirates, but costs 10 days in valuable travel time.²¹ Travelling through the Arctic along the Northern Sea Route demands favorable ice conditions, Russian approval, and specialized ship equipment, making it more expensive.

Piracy

Piracy differs from terrorism in that it is financially rather than politically motivated. The financial gains from piracy may be used for political landside operations, criminal enterprises, or purely as a financial endeavor. The line between the two blur when funds are raised through piracy for political objectives. Both acts are criminal under international law;²² however, counterterrorism is typically a state responsibility, while responsibility for counterpiracy is handled by companies, until the piracy escalates beyond what the private sector can handle.²³

How does piracy affect our shipment in transit? There is piracy across the world. Most relevant to our hypothetical shipment is active piracy in the Strait of Malacca and off the coast of East Africa. Starting in 2008, maritime shipping has been heavily affected by East African piracy.²⁴ For example, Somali piracy in the Gulf of Aden is estimated to cost over \$18 billion (USD) annually.²⁵ After a coordinated effort by various states and implementation of private sector counter-piracy measures on ships, ship capture rates by pirates have declined to zero in 2014 off

Primary Global Shipping Routes



the coast of East Africa. As a result, financiers of Somali piracy have reportedly become reticent to finance piracy efforts as the return on investment has dwindled.²⁶ While this is encouraging news for our shipment, it does not mean that the threat of piracy is gone: it is the continued use of counter-piracy technology and other counter-piracy measures by states that causes piracy to be unprofitable in the region. Thus, though currently dormant, piracy remains a risk in East Africa.

Though Somali piracy has dwindled, there has been a resurgence of piracy in the Strait of Malacca. Located in Southeast Asia, the Strait of Malacca is a key passageway for trade between Asia, Africa, Europe, and the US East Coast. At its narrowest point, the Strait is only 1.7 miles wide, creating a geographical bottleneck. It is the second of the world's "most strategic [energy] choke points," according to the US Energy Information Administration.²⁷ Pirates' targets have primarily been small oil tankers, attacked by armed gangs with knives and guns. This is good news for our cargo: as goods are more difficult than commodities to resell, it is less attractive to pirates.

Overall, global piracy has been on an upward trajectory,²⁸ ebbing and receding based on opportunity and defense. In early 2000, piracy attacks peaked in the Strait of Malacca. It was not until 2004 that significant measures were taken to secure the strait.²⁹ With a significant global response, piracy declined and states diverted their interest elsewhere. The cost of piracy to maritime trade varies: with recent downturns in piracy, response costs are expected to decrease further.³⁰

Canals

While states along various straits or sea passages have an interest in reducing piracy, states operating paid canals have a different set of considerations. During the Arab Spring, despite fears that shipping would stop through the Suez Canal, ships continued to pass through, demonstrating the superiority of trade over political dispute.

While canals regularly operate without security incident, security considerations are never far from their operations. In the security world, the Suez Canal is most often thought of in the context of the Suez Crisis in the 1950s. During the Suez Crisis, the UK and France lost control of the canal to the Egyptian government, raising key questions over the future of maritime trade through the canal. The recent Arab Spring resurrected security and geopolitical concerns for shipping. But the economic benefits of the canal created an incentive for Egyptians to keep the Canal open, to the tune of \$5 billion (USD) in revenue a year.³¹ The high dividend of peace proved to be a stabilizing factor, even during recent uprisings of the Arab Spring.

The Suez Canal is undergoing an expensive remodeling in order to increase capacity. The canal can already take ships larger than Panamax—the largest ship size able to cross through the Panama Canal. In 2013, Maersk, the world's largest container shipping company, decided to stop using the Panama Canal, and

instead use the Suez Canal to ship from Asia to the US East Coast.³² This reflects a wider trend of transit through the Suez Canal becoming the preferred choice for shipping from Asia to US East Coast.³³ Larger ships mean that fewer ships are needed, enabling shippers to lower costs through economies of scale. In turn, this increases the strategic value of the Suez Canal.

While political challenges in Egypt and regional conflicts are concerning on a larger geopolitical front, their impact has been minimal on shipping through the Suez Canal. Because the canal represents a significant revenue source for the Egyptian state, Egypt has an incentive to keep the canal safe and operational. The canal is also a source of pride for Egyptians, leading millions to buy investment certificates to support the canal's expansion plans.³⁴

“Overall, global piracy has been on an upward trajectory, ebbing and receding based on opportunity and defense.”

Ships sailing via the Suez Canal to the US East Coast may make a call at a European port. This can increase security concerns, as it increases the handling points of your shipment.

If instead of going west, either by the Suez Canal or around the Cape of Good Hope, your shipment could head east. It would have crossed the Pacific Ocean and then onward to a US East Coast port. It would need to navigate either the Panama Canal, or the Cape Horn. The Panama Canal is often preferred due to saving approximately 10 days of shipping time, or over 4,500 miles, compared to the Suez Canal or the Cape of Good Hope.³⁵

The security concerns surrounding the Panama Canal are more safety oriented and geopolitical. Safety-wise, the frequency of large ships means that careful navigation is necessary to avoid collisions.³⁶ Around 5% of global seaborne trade, and 12% of American international shipping, passes through the Panama Canal.³⁷ In contrast to the Suez Canal's complicated formula for tolls, Panama charges a flat rate based on net ton. Between 10,000-15,000 ships pass through the Panama Canal yearly, paying an average toll of \$54,000 (USD).³⁸ Transit fees increased in 2013, as the Canal authority sought to fund its ongoing \$5.25 billion (USD) expansion.³⁹ For East Coast ports, the Panama Canal expansion represents an important possibility encouraging more trade, rather than having ships dock on the West Coast and then transport goods over land.⁴⁰

Geopolitics and Sea Routes

Geopolitics have long been part of sea routes. Ships chose ports and routes based on geopolitics in both subtle and explicit ways. On the face of it, geopolitics does not threaten shipping security. Instead, geopolitical considerations are rooted in the options which trade bestows: economic security spurs diplomatic and



A cargo ship in the San Francisco Bay fully loaded with containers (Bernard & Myrtha Garon).

security posturing between states.

States seek to amend the geopolitical chess table through facilitating routes favorable to their trade flow. For example, China and Russia support a Nicaraguan Inter-oceanic Grand Canal to rival the Panama Canal.⁴¹ This support has several implications. The first is symbolic: the Panama Canal's historic connection to the US coincided with the US' growth into the world's mega-economy. Secondly, the deal is extremely practical. With the Hong Kong based HKND Group gaining the right to build and operate the Nicaraguan Inter-oceanic Grand Canal for 100 years, China has an opportunity to shape the flow of trade. In turn, shipments of Chinese goods to the US East Coast and to Europe can move with greater ease. For Russia, the deal is a way to exert greater influence in the region.⁴²

Even travel across the Arctic through the Northern Sea Route (NSR) has a geopolitical element, as approval is needed from Russian authorities in order to begin the journey. Travel along the NSR, north of the Russian border, has become increasingly viable given warming conditions in the Arctic. While the journey time is shorter when travelling between Asia to Europe, its benefits are less clear for US destined cargo. NSR travel incurs extra risk: ships traversing the Arctic need specialist crew training and equipment in order to operate safely. Russia operates the Search and Rescue Area in the NSR and requires icebreaker

escort. Russia's control over the passage increases the political risk of NSR transit.

Despite the uptick in interest in the region, actual passages remain few. Four vessels made the crossing in 2010, 34 in 2011, and 46 in 2012.⁴³ Still, Russia has made it clear that it is interested in promoting the development of the NSR, as well as asserting its exclusive jurisdiction over it.⁴⁴ Currently, Arctic shipping is primarily intra-Arctic, transporting goods from one Arctic port to another. With no direct security threats to Arctic shipping, geopolitical security questions may spill over to affecting NSR transit. Still, when the scales between geopolitics and money are evaluated, geopolitics weigh less. Should the NSR become more popular, the impact of western tensions with Russia would be negligible, as long as western shippers are willing to pay the tolls needed to pass.

When maritime security fails along any of these routes, prices shift, states are called upon to respond, or shipping companies decide to turn private security firms in order to protect their cargo. With all of these complicated decision points, it is unsurprising that so many shipments from China to the US go directly across the Pacific Ocean to the popular ports of Los Angeles and Long Beach.

All in all, route choice is a balance between risk mitigation, cost, time, and reliability, with each element tied into security concerns. As a response, hundreds of different security firms now offer maritime protection services, with the UK serving as a hub for these firms. With the continued willingness of shippers to employ maritime security firms,⁴⁵ maritime route security will continue to be a burden primarily dealt with in the private sector, but enabled through state actions.

Insurance Considerations

Insurance is an important complement to any shipping endeavor, as it can offset the potential losses due to risks encountered. It also shifts actors' willingness to engage in security incidents. In essence, maritime insurance is the monetization of maritime security.

Maritime insurance has existed since the advent of modern shipping. In 18th century, underwriters took on the risk of losses in return for a proportion of the profits. They soon learned to inspect ships before deciding whether to insure them, leading to the first classification societies and ships standards. In 1906, the UK's Marine Insurance Act was enacted, leading to new standards in maritime insurance worldwide. Today, maritime insurance encompasses a wide range of categories, from insuring aspects of the ship to the items being transported; most relevant for a company is cargo insurance. Cargo insurance covers the specific cargo of the ship, as well as passenger belongings. Insurance coverage is often either based on the voyage, covering the time the goods are between ports, or more commonly, a specified time period.

Insurance is important because of its role in the event the security of the goods is threatened. If the goods are replaceable, and insurance premiums acceptable, it becomes more viable to write goods off, rather than seeking their recovery. However, when insurance premiums rise to untenable levels, the calculus shifts. The calculus for crewmen lives is quite different. In the case of piracy, the focus on ransom is on the lives of the crew, rather than ransoming the cargo. This focus is for simple reasons: pirates rarely know what cargo they have captured. By contrast, the ransom for people is much more straightforward: about \$2 million (USD) per person.⁴⁶

As piracy rose in 2008, there were questions whether the marine insurance industry would be able to handle the rise in payouts. Still, premiums charged more than covered the payouts.⁴⁷ Insurers were also more concerned with commodities shipments, such as oil tankers, as these ships are easier to seize by pirates. Because of their construction, container ships ride higher in the water, making them harder to take by the small boats pirates use.⁴⁸

In sum: a company will choose to insure cargo based on risk tolerance. Insurance has an effect on the value of piracy, and, in turn, piracy can increase the value of insurance. The containers of widgets on their way to Nebraska from China are at little risk,

because they are on a container ship. Further, the rate of incidents is low, depending on the route taken. Still, the company is likely to want to have an insurance policy in place to buffer any losses. As a result, the company would insure.

Maritime Trade & Security: Inseparably Linked

Day-to-day maritime security ensures the safe passage of container ships, oil tankers, bulk carriers, and all the other vessels that transport goods and people over the seas. In turn, the security of maritime sea-lanes, ports of call, and the infrastructure supporting sea-trade are essential to the global and national stability. Without consideration of the maritime trade dimension in maritime security, states risk undermining the trade upon which the global economy and nations so depend.

While trade represents business decisions, policy makers and businesses must recognize that these are decisions made in a highly geopolitical environment. This has been true since the beginning of international shipping, but has become particularly true in our ever-more interdependent world. The decisions presented in our hypothetical are multiplied over thousands of companies and thousands of shipments each year. Companies make decisions based on their own immediate cost-benefit analyses. Yet, their decisions are have influenced by and affect the maritime security environment.

Somali pirates would not have become so powerful if they had not been located near a bottleneck of major trade routes. Similarly, the Suez and Panama Canals are located in volatile regions of the world. The trade implications of any instability surrounding the canals heighten interest and tensions in these regions. The canals are choke points in maritime trade, and thus are a scarce resource. "Resources that are both economically important and scarce can produce conflict between the nations and groups who need and/or use them."⁴⁹

“Without consideration of the maritime trade dimension in maritime security, states risk undermining the trade upon which the global economy and nations so depend.”

As countries and ports collaborate to improve maritime security, both of ports and of ships with the goods they carry, a framework of governance is emerging. The high seas are still a global frontier, but this does not mean that they are a lawless Wild West. The maritime industry, specifically the shipping industry, has developed a robust self-governance structure that has supported trade and commercial stability over the centuries.

Governments and international organizations have mostly built upon that structure to good effect.

The interests of governments play an important role, particularly in protecting their territory and people. However, maritime trade operates in a global commons. Protecting the “Critical Infrastructure” of maritime trade must happen at a global level. International organizations will need to complement private sector solutions in order to protect maritime security for the good of global economic resiliency. A multi-stakeholder model in maritime security is essential for the future of maritime trade.

The next logical question to address is the relative role of actors in the multi-stakeholder model and how to most effectively sustain maritime trade’s resiliency and security. However, addressing the question would require an entire article itself. Questions which would, ideally, be addressed include:

- Should stakeholders work to simplify the governance structure, or should they accept the complexity of overlapping jurisdictions as part of maintaining flexibility?
- How should states protect their self-interest without damaging the global common good that is maritime trade?

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